THE CHALLENGE OF DEVALUATION

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FOREWORD

THE INDIAN RUPEE was devalued suddenly on June 6, 1966. 'Devaluation had to be resorted to' in the words of the Prime Minister 'as a lesser evil' and 'to wriggle out of the morass in which the country was writhing.' Explaining the circumstances which prompted the sudden decision, the Finance Minister observed that the foreign exchange position was so difficult that unless Aid began to flow soon in adequate quantities, there was every danger of the economy receiving a serious setback. Import restrictions were hurting industrial production badly. Agriculture was stagnant. The commitments ahead for debt repayments were heavy. 'Action could not be postponed as all further Aid negotiations hinged on it.' It was obvious that the situation was extremely critical and a drastic remedy was called for. Devaluation offers an opportunity to rectify past mistakes and re-orient our economic policies on sound lines.

It is true that devaluation is expected to confer certain benefits on the economy in the long-run. But the realization of these benefits would depend upon the extent to which the economy is able to adjust to the changed conditions without generating disturbances in the process. This, in turn, would depend upon the post-devaluation economic strategy and follow-up action.

It is against this background that the Indian Merchants' Chamber convened a Seminar on 'Challenge of Devaluation' to provoke thinking on the appropriate type of follow-up action. It was addressed by the Governor of the Reserve Bank, Shri P. C. Bhattacharyya. Industrialists, bankers, economists and journalists were present and participated in the Seminar thus providing an opportunity to exchange ideas on the much needed follow-up action. The accent in the discussions was to evolve a practicable course of action. Since the subject is of far-reaching significance at the moment, it has been thought desirable to bring out the proceedings of the Seminar for public benefit. The address of the Governor of the Reserve Bank to the Seminar, the various background papers which served as a valuable base for discussions and the Statement of Conclusions and Recommendations which emerged from the Seminar are also included in the publication. I hope it will stimulate further thinking on this vital problem.

(Ramnath A. Podar)
President

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Background Papers

Paper I

EXPERIMENTS WITH DEVALUATION—WHAT THEY TEACH?

S. L. SARMA

HARROD, the noted Economist, wrote in his book *Policy Against Inflation*, that the devaluation of the pound in 1949 was caused by the American 'back-room boys' in an attempt to solve the British problem for them, as the British seemed unable to find their own solution. There have been doubts expressed in certain quarters though denied by official agencies, that similar pressures have worked on India and satisfaction is drawn by citing illustrations of Great Britain, France and Yugoslavia which devalued their currencies in 1949, 1957-58 and 1965 respectively.

To clarify the issues involved let us recapitulate the situation in India on the eve of the current devaluation. Since the Third Five Year Plan, and more particularly after the Chinese aggression, followed by the Pakistani adventure, the country has been in the grip of serious production bottlenecks. Apart from the food difficulties, the basic foundation of its planned thrust in the industrial sector has stood shaken by the grinding halt of its productive apparatus. Her rate of industrial production which was anticipated to touch 11 per cent per annum hardly reached 8 per cent during the Third Plan. The internal inflationary pressures

have increased partly owing to heavy defence expenditure and partly from non-productive developmental spending. The prices of Indian products have been out of alignment with international prices on account of rising costs and therefore the export drive was backed by several administrative and policy measures which enabled them to compete effectively. Export incentives were designed to eliminate the disadvantage of price disparity and yield larger profit-margins compared with those enjoyed in the domestic market.

Indian exports have in effect been constrained by twin factors of demand-pull and cost-push inflation and the sheltered home market. Schemes of import-entitlement, and other promotion measures were, therefore, intended to partly overcome the strong disincentive to exporting and partly to remove the disparities in the export and import prices which made the terms of trade more adverse to India—an experience common to all the developing countries.

Pressure of Imports

Devaluation of the rupee is expected to correct the chronic external balance of trade and payments deficit which India has been facing for over a decade. India's trade deficit in 1964-65 stood at Rs. 593.3 crores and her payments deficit at Rs. 436.7 crores. The pressure of imports has been steadily mounting since planning began without compensatory increases being recorded either on the side of exports or invisibles. There is also little possibility of the import bill going down in the near future. In other words, there is little evidence to show that India's external deficit has been caused by her monetary internal inflation. On the contrary, it is explained by her development strategy, or the lack of export surpluses forthcoming either from the agricultural or industrial sectors. little export orientation of her industries or management and the protective umbrella over the home-market. In addition, exports did not rise fast enough owing to the shipping difficulties and port bottlenecks whose role and contribution has never been fully appreciated in our export development until lately. Thus rising costs in India cannot be ascribed only to the internal inflationary pressure but also to higher costs of imported inputs, rigidity of the supply-sources forming a part

of project imports and in consequence costlier supplies, adverse shipping freight rates, procedural and other delays etc. India has been depending heavily on foreign aid and her debt service and repayment obligations have been increasing. Her development strategy has been to create the necessary infra-structure and basic industries with a high degree of import substitution programme. This did not yield exportable surpluses in our traditional sector which still constituted 60.7 per cent of our exports, nor contributed directly to their quality improvement etc. In the net analysis the composition of exports did not alter substantially over the years of planning to enable the country to enjoy the benefits of developmental programmes. Confronted by the alternatives of either reducing the size of her plans or investment programme or push up exports to finance imports, the country was hustled into devaluation.

British Experience

Parallelism is drawn with Great Britain, France, Yugoslavia and other countries which have resorted to devaluation of their currencies from time to time. It will, therefore, be educative and interesting, to recapitulate here some of the basic facts of economic history pertaining to these three countries. To compare India of today with either of these countries in their pre-devaluation periods is erroneous for several reasons. It was after World War II that Great Britain and other European countries were still in the throes of economic reconstruction. By 1949, the UK had greatly succeeded in achieving peak levels of production and employment. Her investment was geared to a high pitch, and management and labour relations were harmonious; her exports touched a new high of 150 per cent (volume) compared with 1938. Imports were pegged at 80 per cent of their pre-war level through special measures; prices were held in check by governmental control and the demand was curbed through rationing of commodities. On the export side, the Government forced selected industries to export a certain proportion of their outputs; automobile, pottery and other industries seeking expansion shared this compulsion. Inflation flowing from the conditions of full employment made British goods highly uncompetitive in the world markets. The UK was unable to earn

enough dollars to import essential raw materials and food from the USA which was left as the only source of supply after the war. This caused continuing pressure of her dollar resources. The Government tried to curb the dollar craze but did not succeed. A steep fall in UK's exports to USA and Canada on account of heavy US inventory recession about this time led to a sharp fall in Britain's export earnings. This led to the devaluation of the pound by 31 per cent on 18 September, 1949. The dollar gap was thus bridged for the time being. The gold and dollar deficit of the sterling area running at the quarterly rate of more than $1,000 million in 1947, and $420 million in 1948, turned into a surplus of $40 million by the first quarter of 1950.

The situation, however, was not so simple as described above. The UK balance of trade position in 1949 was better than that in 1948, but did not continue to be so in 1950. Her imports prior to devaluation and after remained under rigid control and the limitations could not be ascribed to their becoming more expensive since the devaluation. Exports of course rose but several factors contributed to them viz., the high level of world demand for raw materials originating from the sterling area, 25 per cent cut in dollar imports agreed to by the entire sterling area in 1949 etc. The index of import prices and the terms of trade for the UK worsened. Consequently the inflationary pressure increased. Higher import prices led to the higher cost of living. An upsurge in retail and wholesale prices led to higher wage increases. As output did not keep pace, devaluation gave a fillip to domestic inflation. We must remember that this happened in the UK despite her being a highly developed economy both industrially and technologically. Her exports also enjoyed traditional preference in the foreign markets and she continued to have stable raw material supply sources in the Commonwealth countries whose Governments devalued their respective currencies to retain their share of the UK market.

The French Miracle

The experience of France is rather different. Her gold and foreign exchange holdings had touched a new low of $645 million in 1957 compared to $1,912 million of 1965. Unlike the UK,

her index of wholesale prices rose higher than that of the USA creating an impression that her goods were uncompetitive in the US market. This led to the devaluation of Franc in two stages viz., 'operation 20 per cent' which began on 10 August, 1957 and subsequently cancelled on 21 June, 1958. Under this, all imports were subjected to a levy of 20 per cent surcharge and all exports enjoyed a bonus of 20 per cent. The official parity fixed for franc was 1,176 francs to a pound and 420 francs to a dollar. Franc was again devalued on 28 December, 1958 when a decision to replace the old franc by a 'new' one was taken. This had an immediate effect on her trade with the USA. Exports almost doubled from a figure of 1,275 million francs in 1958 to 2,319 million francs in 1959, whereas imports from the USA fell from 2,367 million francs to 2,119 million francs. This gave France a trade surplus of 200 million francs in 1959 against a deficit of 1,092 million francs in 1958. But this gain was only short-lived for, in 1960 imports from USA once again rose sharply and exports fell resulting in a deficit of 1,701 million francs. This position continued in 1961 also, though not to the same degree.

France reaped larger overall benefits from devaluation. From an overall trade deficit of 2,044 million francs in 1958, she enjoyed a surplus of 2,571 million francs in 1959. This surplus was brought about not by any decrease in imports. In fact, her imports increased by 1,577 million francs and her exports by 6,193 million francs between a single year i.e., 1958-59, thus converting the deficit into a surplus.

Such a remarkable turn of events took place on account of several reasons. First, her exports coming from a partner of the EEC enjoyed a marked preference in member countries. Secondly, her traditional ties with her colonies enabled her to buy her imports cheaper and push up her exports further. Thirdly, the USA was equally interested in enabling France to stabilize her economy because of the former's heavy investment in that country. Fourthly, her devaluation or her attempts to stabilize franc were backed by massive aid provided by various international agencies. For instance, the OEEC channelled $250 million through European payments Union for extending France's settlement facilities; IMF gave $131.25 million of additional standby credits and US $274 million by way of deferring the repayment of various loans and credits. The Central Banks of

UK, West Germany, the Netherlands and Belgium and the Bank for International Settlements also extended credits of the order of $250 million and finally 21 American banks granted a stand-by credit of $200 million to her in 1959. These were, of course, supplemented by 250 tons of gold lent by the Bank of France to the Exchange Stabilization Fund of the country and other advances that it made in the form of franc to the Treasury. She also succeeded in holding the indices of wholesale and consumer prices down as compared to those prevailing prior to devaluation. Her credit control policy following the devaluation was so effective as to cushion the effect of devaluation on domestic prices. The prices of her exports fell but fortunately for her the prices of imports also fell as production expanded faster in Europe. Hence there was no deterioration in her terms of trade following devaluation and a Pinay-Rueff economic miracle proved to be completely successful.

Yugoslavia's Reform

Yugoslavia's experiment too is not wholly applicable to the Indian scene because of the fundamental and basic differences which persist in the two economies despite the reorientation of the former's economy through the 1965 reform. It is too well known that Yugoslavia has had a highly centralized planning with almost all economic activity nationalized—industry, banking, transport, trade and substantially agriculture. Since her breaking away from the Cominform in 1948, she has been experimenting with new 'courses' towards socialism.

The Yugoslavia currency viz., dinar, was devalued in 1952 and was followed by a limited reform in 1961 and another of a far-reaching character in 1965. The material difference which one sees in the latest reform with the Indian devaluation carried out recently is in the structure of the two economies. Indian economy is too free to support the strategy of official direction and measures. The public sector here is too small to 'lead', 'interfere' or even assist the Government in the achievement of its objectives. The distribution system being what it is, the market forces still decide resource-allocation based on profit-incentive rather than socially desired goals. The planning authority or the Government cannot bring about redistribution of national income as

was achieved in Yugoslavia without sacrificing individual freedom. The democratic procedures introduced in Yugoslavia followed the socialistic pattern of society—such a society having been firmly established in the country whereas in India socialism is still a far-cry. Thus the reform of 1965 in Yugoslavia was mounted on the socialized enterprises operating under a system of workers' self-management. The withering away of the State in favour of the 'society' is a phenomenon which came after her economy had been substantially transformed from a predominantly agricultural to a potentially industrial one. The authorities still retained the direction of the flow of investments specially to support export industries and concentrated on the fuller utilization of existing capacities with a shift of emphasis on consumer's goods production, so as to achieve higher export targets without a substantial price rise at home. In consequence, she had enjoyed an average economic growth rate of 7.6 per cent, one of the highest enjoyed by any other country in the world; her industrial output growing at a rate of 17 per cent in 1964. The percentage of her farm population declined from 75 per cent to about 40 per cent to the total rising the per capita income from \$140 shortly before the war to over \$500 in 1964. Thus dilution of authoritarian control is still a part of the socialistic society rather than a symbol of the confused market economy of India. In other words, it is far more easy to introduce reforms, currency and other kinds, in a disciplined society such as Yugoslavia's rather than in India where the Government control over economic activity and market forces is only remote despite State intervention seen here and there. Further, in India unlike Yugoslavia, the State does not possess efficient levers with which to correct distortions as might appear from the new economic policies such as the present currency devaluation.

Hence, parallelisms drawn from the devaluation undertaken by England, France and Yugoslavia lack in similarity either of the structure of their economies with that of India or the Governmental prowess and action which followed reforms. What India has borrowed now is liberalization of imports which followed the devaluation of franc without the massive foreign aid and credit, or without the rigid discipline over prices and imports of Great Britain and a cushion of colonies for supplementing imports and exports enjoyed by both France and Great

Britain without the socialist ownership of the means of production as in Yugoslavia. Then, what follows the Indian devaluation is bound to remain a unique experiment of its own, for even otherwise comparisons are hard to draw.

India has had her own lesson from the previous devaluation of her rupee in 1949, which came in the wake of British decision to devalue the pound. In fact, the Indian devaluation was only an effort to maintain the same exchange rate with the sterling although in terms of US dollar it declined by 3.5 per cent. With the latest devaluation the exchange rate of rupee stands altered both with the pound and US dollar.

Indian Scene

The differences in the situation experienced in India in 1949 and on the eve of the devaluation are worth recapitulating. The two main reasons which had prompted the devaluation in 1949 are (*i*) to correct the growing deficit in our trade balance, and (*ii*) to concentrate this effort towards the dollar area with which the sterling area (including India) ran a severe deficit. Consequently, India's balance of trade deficit which stood at Rs. 283.8 crores in 1948-49 got reduced to Rs. 3.5 crores in 1950-51. The terms of trade following devaluation improved but moie due to a rise in the prices of exports caused by the Korean boom and stockpiling that followed. Accordingly, the volume of exports from India rose but not at the same pace as that of imports. The latter remained constrained not so much on account of the devaluation having made them costlier but the Government of India applying rigid import control in accordance with the decisions taken at the Commonwealth Conference in early 1949 by which the Sterling Area countries agreed to limit them to 78 per cent of the 1948 level. We see here again an interesting difference in the comparative situation then and now. The present devaluation has been followed up by liberalization of imports rather than a cut and of course there is no stockpiling programme round the corner to either increase the prices of our exports or their volume more than proportionately. This obviously has been done in the belief that more foreign aid is likely to flow. For one thing, with the devalued rupee its foreign exchange content may turn out to be smaller on account of the higher im-

port costs. For another, the aid may still remain unutilized, as happened in the past, failing to create the impact that is now desired. The aid authorized during April 1961 to March 1965 was one of the order of Rs. 2,274.7 crores with the total aid available for utilization going up to Rs. 3,577 crores but the estimated utilization has been only Rs. 2,100 crores leaving an undisbursed balance of Rs. 1,476.9 crores at the end of 1965. What impact could this balance have on our economy? Perhaps the country could have stayed off devaluation? However, cumbersome procedures and shipping bottlenecks on the one hand and the faulty project-preparation on the other did not allow the full benefits of aid to be reaped. Therefore, if foreign aid is expected now to support the step taken, structural changes both on the side of aid-giving country and India are of immediate necessity.

In the existing Indian conditions, the twin expected gains of devaluation viz. higher export proceeds and lower imports are unobtainable for the latter are highly inelastic. The superstructure which has been established in the field of heavy engineering industries or the key projects require a continuous flow of imports despite substantial gains made during the plans in import substitution on the side of several consumer and producer end-products. The growth needs of our economy being vast, the pressure gets shifted from one type of imports to another without the total burden on the economy getting reduced.

In the field of exports too there is only a narrow margin—within which legitimate differences of views may arise on the measure of foreign demand response or its elasticity to any given price-change. From this picture we must rule out the traditional items on whose price-inelasticities volumes have been written in the United Nations. Tea, jute, textiles and a few other commodities fall in this category. Exports of tea, for instance, declined from 61 per cent of output in 1955-56 to 57 per cent in 1964-65; of jute textiles, the percentage of export to production went down from 82 per cent to 75 per cent and of cotton mill-made cloth from 13 per cent to 10 per cent during these years. In other words, the scope of manoeuvrability for enlarging exports is very limited. Ceylonese tea has been a standing competitor to Indian tea and had our superiority not been in question we would perhaps still stand by our old customers

rather than woo new ones. In jute, Pakistan could hardly be expected to sit idle when exports have been enjoying an edge over ours for some time. Textile exports are governed by quotas and devaluation can hardly change the situation in our favour unless we are looking for new markets which are already nursed by countries like Japan, Hong Kong etc. Coffee exports too fall within the quota system while sugar is sold according to a negotiated price and agreement. In fact, the developing countries, and India being one of them, have been carrying out a relentless war against quota restrictions imposed by advanced countries of the world. But this has had little effect. Devaluation of the currency, therefore, does not give any additional advantage on the negotiating table. Perhaps it acts to the contrary by putting up the back of the buyers who are alergic to allow any inroads into their vulnerable areas (agricultural products, traditional domestic industries) by either the cheap-wage products of the developing countries or made cheaper through devaluation.

The traditional exports of India constitute approximately 61 per cent of the total where certain marginal increases in export earnings can be expected but not entirely without being challenged by the countervailing measures taken by our competitors. India must, therefore, look to the non-traditional items for gains from devaluation. Unfortunately, the manoeuvrability in the Engineering goods line is also not readily available since our exports have hardly touched Rs. 16-19 crores. Their present composition is too ineffective to derive larger benefits from a fall in the exchange value of the rupee. Moreover, they continue to rely on imports either for expansion, balancing, renovation of plants or for basic raw materials and components for their production and assemblies which have gone costlier. Such a rise in cost must be compensated by other gains such as ought to come through higher capacity utilization, higher labour productivity, economies of various types and avoidance of wastes etc. Excepting fuller capacity utilization which can be achieved by liberalization of imports, other gains are possible when imports are costlier. Therefore, whether import liberalization will enable industry to cut costs all along the line is still debatable. This is

an area which has to be attacked by training or management, demonstrations and compulsion which required a long-term perspective on the part of Indian industry. Even then one must assume that non-traditional exports will move faster provided adequate care is taken about the quality and packing supported by more sustained and vigorous salesmanship. Competence for selling abroad cannot be acquired overnight. Had some of these factors such as quality, cost-consciousness, aggressive salesmanship etc. been present in the required measures in Indian industry or its products, the vehicle of devaluation perhaps would not be called in, at least not into this degree, to augment our exports.

The decision to devalue having been taken, the country has to stand together. An appeal to nationalism has failed to remedy the evils of tax-evasion, under-invoicing and over-invoicing, unofficial dealings of foreign exchange etc. The Government is also handicapped owing to the vast majority of India's population belonging to the rural sector and, therefore, not being amenable to the national financial and fiscal discipline. The distribution trade—both wholesale and retail—is not only free but is in the hands of hereditary classes. There is no minumum qualifications prescribed for those who run the distributive establishment unlike the Scandinavian countries, to ensure efficiency, consumer service and a national approach. Manufacturing too is controlled by private endeavour and is not wholly under official discipline excepting for the initial licensing done. Although the economy is mixed, the market forces are free to operate. Therefore, distortions appear on the market scene from time to time and the Government is unable to correct them. Since only a very small portion of the economy is under State control, the State does not possess the operative levers by which it can divert or reallocate investment. Planning mixed with the democratic ideal has its own dilatory processes. With all these handicaps, it should still be possible to neutralize the effect of devaluation on internal prices of essential commodities. Enough has already been said about this being achieved through fuller utilization of capacity, raising of agricultural and industrial output, holding the price-line and effective wage 'pause' etc. These

ought to be done even if it means tightening of the belt and personal discomfort. Britishers did it and the Yugoslavas sacrificed their comforts when they faced such decisions. In India, however, this may not be achieved so easily.

Imports

As soon as the costlier imports start flowing into the Indian system, the price level is bound to be pushed up with sympathetic rises in other segments. Import substitution itself is based on liberal imports which will be costlier. The price which the country will have to pay for import substitution and self-reliance will, therefore, be higher. Selective liberalization of imports which has been announced to accelerate production in certain industries is no guarantee against the re-emergence of the open market for industries not so favourably placed. The flow of precious raw materials from large-scale to small sector and *vice versa* cannot be checked unless Government vigil is increased. This will create further problems. Export industries, as will be established under the incentive of devaluation will require long gestation to yield results. Existing industries may still find export orientation less attractive than the profits offered by the domestic market and the export duties, therefore, may not be accepted by the industries without protest.

In a world where foreign trade of a country requires more than blanket policy measures one can hardly solve the problems with the 'open strategy of devaluation.' Our competitors, particularly in the traditional fields must have already taken recourse to several hidden and open countervailing steps. We, too, on our part may not entirely escape the need to offer additional incentives. That these are necessary is already evident from the stalemate that has come about in our trade with the USSR and other countries of this bloc. Further, certain industries have already asked for more incentives to enable them to export. Therefore, correctives to disparities between the domestic and foreign prices lie in reduced costs which can be achieved by re-orienting our licensing policy towards more economic size, favourable location, check on wastages and by expanding the productivity drive with zeal and enthusiasm. Selective deflationary policies

which ought to have been initiated instead of devaluation have still their validity. Therefore, Shri Morarji Desai, has wonderfully summed up the directions in which our future efforts lie. We might add one more and that is a drastic overhaul of the system of aid utilization.

(By arrangement with the *Economic Times*)

Paper II

CRITERIA FOR DEVALUATION

NAROTTAM SHAH

In this paper, we shall proceed on the assumption that the government takes its decision on such an issue as devaluation wholly on the basis of its merits and that the government is free from any external pressure which could compel it to take decisions which, it knows, are harmful to the economy. In other words, we assume that reliance on the foreign aid or some such other consideration does not make the government utterly helpless before the external pressures such as those which were evident when the recent decision on devaluation was taken.

In addition to the criteria which should be applied when a decision on devaluation is to be taken, we shall also discuss some important elements of the strategy that we should adopt for maintaining and defending the external value of rupee.

Relevance of the External Value

Quite frequently, it is regarded as almost axiomatic that if rupee is over-valued, it should be devalued. This is a rather over-simplified view of the problem. In so far as the over-valuation (of our currency) *per se* is concerned, we need not bother about it. We should start worrying about the problem only

when and in so far as the over-valuation leads to a chronic deficit in our balance of trade. In this connection, it is significant to note that, for decades, the Soviet Union could with impunity maintain the external value of rouble at a highly inflated level because by skilfully using the bilateral trade mechanism, it took care to see that its foreign trade did not develop any significant deficit. This lesson has a universal significance. If through suitable import controls, any country can keep its imports within the limits permitted by its export earnings, it can ignore over-valuation of its currency. Such a policy would be advantageous to the country because an over-valued currency *ceteris paribus* ensures better terms of trade. We in India would do we to keep this in mind whenever we discuss the problem of the exchange rate of rupee.

It is sometimes forgotten that increasing our exports is not the only way of reducing the gap in our balance of trade: reduction of imports is an equally useful way. Indeed, while the former depends on many factors which are beyond our control, the latter is wholly within our control, provided there is the necessary will to do it.

At the same time, there is no denying that we should keep a careful watch on the external value of rupee, because in so far as we are unable to develop the bilateral trade mechanism, and to the extent, consequently, the over-valuation of rupee hampers the required expansion of our exports, the problem of the external value of rupee should certainly be regarded as important.

Need for Quantitative Criteria

Here we face an important question. How do we assess quantitatively the degree of over-valuation of rupee? For, without some quantitative criteria, we would lack reliable data required for keeping a constant watch on the external value of rupee. Further, if and when we do decide to devalue, no correct decision on the quantum of devaluation required can be made unless we have some quantitative indicators. In this connection, it is important to note that the magnitudes of devaluations effected both in September 1949 and June 1966 were entirely arbitrary. In September 1949, we devalued by 30 per cent only

because the Britishers had devalued by that per cent: it was also officially admitted that it was a rather over-devaluation. This time, so far, nobody has explained the rationale behind the precise figure of 36.5 per cent. Obviously the situation in this regard is unsatisfactory and some thinking on this question is badly required.

A False Criterion

A measure of the alleged over-valuation of rupee which catches the popular imagination so easily is the value of rupee in the smugglers' market (in Bombay, Calcutta, Delhi, Persian Gulf, Aden, East Africa, Singapore, Hong Kong, etc.). It is widely believed that these 'unofficial' exchange rates reflect the true external value of rupee. Judged by these rates, rupee was over-valued by more than 100 per cent before devaluation and even now the rupee is over-valued by about 50 per cent.

A moment's thought would, however, make it clear that these quotations cannot be accepted as valid indicators of the over-valuation of rupee.

For example, let us take the pre-devaluation unofficial rates: one rupee=9 cents or 8 pence. This meant that the official value

Table 1

VALUE OF THE INDIAN RUPEE IN THE UNOFFICIAL MARKET

	Value of rupee		*Over-valuation of rupee*
	Official	*Unofficial*	*(per cent)*
Before devaluation			
In US cents	21.01	9.09	131.13
In UK pence	18.00	8.28	117.39
After devaluation			
In US cents	13.33	8.65	54.10
In UK pence	11.43	7.56	51.19

SOURCE: *The Economic Times*, 12 June and 14 July 1966

NOTE: The figures in col. (3) have been worked out on the assumption that unofficial rates reflect the true value of rupee.

of rupee was about 120 per cent higher than its so called real value. Had it been really so, the very fact that we were able to export for the last 15 years or so Rs. 600 to Rs. 800 crores worth of goods a year would become completely inexplicable. If we leave out the non-traditional items which constitute a small proportion of our total exports and compare our export prices with the world export prices for our traditional items (like jute, tea, cotton textiles, iron ore, oilcake, etc.), we do not find any large difference in the prices which would suggest an over-valuation (in the pre-devaluation official exehange rate of rupee) of the order of 100 per cent. Before devaluation, normally we did not offer (in rupees) a price which when converted at official rates turned out (in foreign currencies) to be twice the price offered by our competitors. (This, indeed, should have been the position if the unofficial exchange rates reflected the true external value of rupee.) This contention is fully borne out by a study of comparative prices of about three-fourths of our exports. Obviously, the unofficial rates prevailing in the smugglers' exchange market are entirely unreliable as indicators of the possible overvaluation of rupee.

What then is the precise significance of the fantastic exchange rates prevailing in the smugglers' market? Why such sharp differences between the official rates and these rates? The answers can be made clear with the help of a hypothetical example. Let us suppose that today rupee is once again devalued (so to say over-devalued) by another 50 per cent or even some higher per cent, so that the world's demand for our exports swells up fantastically and our demand for imports from abroad is drastically cut down just because the Indian importers find that the rupee prices of the imports are prohibitively high. Let us suppose further that both these movements are so strong that India develops a chronic surplus in its balance of trade and that as a result all the import controls, except the ban on gold and some luxury items like transitors, tape recorders, cosmetics, etc., are removed. Under such a condition, nobody would suggest that rupee is over-valued. What would happen then? So long as there are at least some buyers in this country who are prepared to pay very high prices for the banned items, smugglers will readily smuggle in these items from abroad. In order to acquire the necessary pounds or dollars for the contraband trade, these

smugglers will have to offer rates higher than the official rates. The smugglers' offer will have to be higher than what the economists call 'opportunity cost' of the foreign exchange (which is equal, at least, to the official rate) plus some reward which the sellers of the foreign currencies expect for entering into such illegal transactions.

We would then have a curious spectacle. On the one hand, Indian exporters would outsell most of our competitors by a very wide margin in the world market and the foreigners would find it difficult to sell their goods in India even though there is no ban in India on the import of most of their products. Indeed in such a situation some of the foreigners might raise the demand that the rupee which is rather under-valued should be revalued upwards. On the other hand, just because some Indians are keen to buy gold or the banned luxury items, even at some fancy prices, the exchange rate for rupee in the smugglers' market would be much lower than the official rates. Such a divergence between the official and unofficial exchange rates for rupee should not be regarded as a measure of some over-valuation in the official rates (indeed at the official rates, rupee would be *under*-valued), but only a measure of intensity of demand in India for items like gold and other luxury items, the import of which has been officially banned.

It is thus clear that the unofficial rates in the smugglers' exchange market cannot be accepted as reliable indicators of the true value of rupee.

All this is rather elementary economics and would hardly merit the attention we have given it here. Yet this issue had to be discussed at some length because the spokesmen of the Government of India have recently started using the pre-devaluation exchange rates in the smugglers' market to justify the devaluation measure (*vide*. for example, the argument put forth by the Finance Minister Mr Sachin Chaudhuri at the July 19, 1966 meeting of the Congress Working Committee held at New Delhi).

In this connection, it may be recalled that before devaluation, when the critics of the government used to quote the unofficial exchange rates for rupee to argue that at the official rates of exchange, the rupee was rather over-valued, official spokemen used to maintain vehemently—and correctly—that the rates in

the smugglers' exchange market could not be regarded as valid indicators of the true value of rupee.

Domestic Prices

Another indicator of the measure of the over-valuation of rupee which has been widely used by the authorities during the current controversy on devaluation is the increase in the domestic prices during the last decade.

Thus in the the course of his radio speech on the fateful night of 5-6 June, this is how the Finance Minister argued in vindication of devaluation of rupee:

> There is little doubt that the value of the rupee today is not what it was ten years ago. You all know that internal level of prices have been rising for some years. Today the general level of prices is 80 per cent more than what it was ten years ago. On the other hand the official par value of the rupee has remained unchanged since 1949. Prices have not risen to anything like this extent in the main countries of the world with whom we trade and in consequence our exports have been meeting increasing resistance in foreign markets. . .
> We had, therefore, to devise a more enduring and reliable way of restoring and indeed increasing the competitive power of our exports. The change that we have made in the par value of the rupee, or devaluation, as it is commonly called, will be precisely this.

A little thought will, however, make it clear that the movement in the domestic prices is not a valid indicator of the possible over-valuation of rupee. For, so far as our exports are concerned, what matters is the movement *not* in the *domestic* prices but in the export prices. Some may be tempted to assume that the movement in export prices would generally tend to be roughly parallel to the movement in the domestic prices, at least over a period of 5 to 10 years. How unfounded such an assumption could be in practice can be seen from Table 2. (p. 20)

From Table 2, it can be seen that during the ten-year period (1955 to 1965), mentioned by the Finance Minister, while the wholesale price index rose by 78 per cent, the export price index

Table 2

INDICES OF WHOLESALE PRICES AND EXPORT PRICES IN INDIA: 1950 TO 1965

	Wholesale price index 1958=100	*Per cent rise*	*Export price index 1958=100*	*Per cent rise*
	(1)	(2)	(3)	(4)
1950	98	—	98	—
1951	108	10.2	143	45.9
1952	95	— 12.1	117	— 18.2
1953	94	— 1.0	100	— 14.6
1954	90	— 4.3	102	2.1
1955	82	— 8.8	100	— 2.0
Per cent rise between 1950 and 1955		— 16.3		+ 2.0
1956	92	+ 12.2	101	1.1
1957	98	6.5	101	—
1958	100	2.0	100	— 1.1
1959	104	4.0	100	—
1960	111	6.8	109	9.0
Per cent rise between 1955 and 1960		35.4		9.0
1961	113	1.8	111	1.9
1962	115	1.7	106	— 4.5
1963	119	3.5	106	—
1964	134	12.6	106	—
1965	146	9.0	112	5.6
Per cent rise between 1960 and 1965		31.5		2.8
Per cent rise between 1955 and 1965		78.0		12.1
Per cent rise between 1950 and 1965		49.0		14.1

SOURCES: (1) I.M.F. *International Financial Statistics*, July, 1966.
(2) I.M.F. *Supplement to 1965-66 Issues of I.F.S.*

rose by only 12.0 per cent. The difference is too large to need any comment. While assessing the degree of possible over-valuation of rupee, we should concentrate our attention on the export price index; to bring the 80 per cent increase in the domestic prices into the discussion as has been done by the Finance Minister and others is clearly incorrect.

Incidentally, we might note here another error which the official spokesmen commit frequently. They generally take the period 1955 to 1965 as a period of reference to calculate the rise in domestic prices. But it is incorrect to take 1955 as a starting point. For the purpose which we have in view, we have to go back to the previous devaluation (September 1949) when an attempt was made to bring the official par value in line with the real value of rupee. Hence if we want to assess the erosion of the *external* value which our rupee has suffered since the previous devaluation, we should take 1950 as a base period. The Finance Minister takes the domestic prices as an indicator. Even then, had 1950 been taken as a base year, he would have got a much smaller figure than the astounding figure of 80 per cent. For, on the whole, the domestic prices fell between 1950 and 1955. Hence, while the increase in the domestic prices was as high as 78 per cent between 1955 and 1965, it was only 49 per cent between 1950 and 1965. The official spokemen generally prefer the period 1955 to 1965, because they thereby get the higher figure of 80 per cent (actually 78 per cent) which looks like a stronger argument to justify devaluation.

Other Countries Too

Even if we were to take the year 1950 as our starting point and rely only on the export price index, it would still not be sufficient. Thus if we find (*vide.* Table 2) that between 1950 and 1965 our export price index rose by 14.3 per cent, it does not necessarily mean that we should devalue by 14.3 per cent, because what is relevant for our purpose is the question: How have our export prices fared when compared to the export prices of (not the countries 'with whom we trade' but) our competitors? We should therefore analyse the comparative data on the movement of export prices of other countries of the world in general and our competitors in particular. Both these types

of data are presented in Tables 3 and 4.

Table 3

INCREASE IN EXPORT PRICES OF LEADING (EXPORTING) COUNTRIES: 1950-1965

		Export Price Index (1958=100) in		*Per cent rise in (2) over (1)*
		1950	*1965*	
1.	Finland	72	108	50.0
2.	West Germany	76	109	43.4
3.	United Kingdom	77	109	41.6
4.	Sweden	73	103	41.1
5.	Norway	79	102	29.1
6.	United States	83	106	27.7
7.	Canada	80	99	23.8
8.	France	84	102	21.4
9.	Netherlands	90	108	20.0
10.	Denmark	91	107	17.6
11.	*India*	98	*112*	*14.3*
12.	Switzerland	99	113	14.1
13.	New Zealand	111	124	11.7
14.	Belgium and Luxemburg	90	98	8.9
15.	Austria	94	102	8.5
16.	Venezuela	86	92	7.0
17.	Japan	102	100	— 2.0
18.	South Africa	105	101 *b*	— 3.8
19.	Brazil	104	99 *b*	— 4.8
20.	Italy	103	94	— 8.7
21.	Malaysia	123 *a*	106 *c*	—13.8
22.	Australia	149	113	—24.2

(*a*) 1952 Index
(*b*) Average for 3 quarters
(*c*) Average for 2 quarters

SOURCE: Col. (1) I.M.F. *Supplement to I.F.S. Issues of 1965-66*
Col. (2) I.M.F. *International Financial Statistics*, July, 1966.

NOTE: From the sources indicated above, all the non-communist countries which had, in 1965, exports of one billion dollar at least, have been included.

Table 4

EXPORT PRICE INDICES OF* INDIA, PAKISTAN, CEYLON AND JAPAN
(1958=100)

Year	*India*	*Pakistan*	*Ceylon*	*Japan*
1950	98	150	103	102
1951	143	202	124	146
1952	117	148	96	119
1953	100	104	98	113
1954	102	111	109	108
1955	100	107	114	109
Per cent rise in 1955 over 1950	2.0	— 28.7	10.7	6.9
1956	101	102	106	114
1957	101	109	102	110
1958	100	100	100	100
1959	100	94	104	104
1960	109	114	104	105
Per cent rise in 1960 over 1955	9.0	6.5	—8.8	—3.7
1961	111	119	95	100
1962	106	115	93	97
1963	106	110	93	100
1964	106	111	93	101
1965	112	130*	94	100
Per cent rise in 1965 over 1960	2.8	14.0	—9.6	—4.8
Per cent rise of 1965 index over 1950 index	14.3	— 13.3	—8.7	—2.0

* Average for the first 3 quarters.

SOURCE: I.M.F. *Supplement to 1965-66 Issues of International Financial Statistics* & *International Financial Statistics*, July, 1966.

From Table 4, it can be seen that over the 15-year period since 1950, while our export price index has shown a *rise* of

14.3 per cent, the corresponding indices for Pakistan, Ceylon and Japan have shown *declines* of 13.3 per cent, 8.7 per cent and 2.0 per cent respectively. If we were guided by these data only (which we need not necessarily) we should have, on 5, June devalued by a percentage somewhat larger than that required to wipe out the 14.3 per cent rise in our export prices, although it would be difficult to suggest any definite and unique figure; the decision would have to be necessarily somewhat arbitrary.

A look at Table 3 would also prove useful. In Table 3, the countries (22 leading exporters of the non-communist world) are ranked according to the descending order of the magnitude of the rise in the export price index of the respective country during the 15-years, 1950 to 1965. The wide divergence in the mangitude in the variation of export prices is quite clear: the range is from a 50.0 per cent *rise* in the case of Finland to a 24.2 per cent *decline* in the case of Australia.

In other words, a *prima facie* case for devaluation in many countries does exist—at least in theory. But, on the other hand, a very important fact to note is that most of these countries do not have devaluation of their respective currencies under active consideration. The implication is that an unfavourable movement in a country's export price index (i.e. an increase higher than that in the case of other countries) does not automatically put devaluation on the agenda. Devaluation is a very serious decision affecting the entire structure of the economy and having wide repercussions both on the immediate and long-term future of the country. That is why, as we know, countries like Britain give a fight to the last ditch before accepting defeat and taking a plunge for devaluation.

We have suggested above that the data on the movement in the export prices of our country and other countries which compete with us in the world market should be used to assess the degree of over-valuation of rupee. But even this is rather too aggregative an approach. What we need is a highly disaggregative approach. To carry the disaggregative analysis to the farthest possible limits, we should set up a special cell in the Ministry of Commerce to compile and analyse a vast amount of commodity-wise data on our export prices and the export prices of competitive products from other countries. An analysis of such data alone can give us some rough idea of the degree of

over-valuation, if any, of our rupee.

At this stage let us define the concept 'over-valuation' a little more precisely, Just like the domestic value of rupee, the external value of rupee also does not have a unique meaning and consequently canot be measured uniquely. *In a general way, in relation to any particular export commodity,* we should regard our rupee as over-valued if the per unit (rupee) price of that commodity when converted into any foreign currency at the ruling official rate of exchange is higher than the similarly converted price of the same commodity offered by a competing country.* To give an illustration, let us suppose that India offers a particular commodity for export at a price of Rs. 750 per unit. Converted into dollars at the prevailing official rate of exchange, this would mean $100 per unit. Let us suppose that a country like Japan offers the same commodity at a price which, when converted into dollars at the current official rate of yen-dollar exchange rate, works out at 90. If we ignore all other factors which could have possibly raised the price of the Indian commodity and attribute our higher price *wholly* to an over-valuation of rupee, it can be said that rupee is over valued and that if we devalue our rupee by 10 per cent, i.e., if the official rate of exchange is reduced from Re.1 = 14 US cents to Re. 1 = 12.6 cents (i.e. lower by 10 per cent), the rupee would cease to be over-valued (in relation to yen so far this particular commodity is concerned) and we would be able to offer Rs. 750 worth of goods at $90 now instead of $100 as was the case before.

Here we should note that the estimate of over-valuation at 10 per cent derived in this hypothetical case is correct only for the particular commodity under consideration *taken in combination with* a particular country (Japan) which we took as the competing country. This means that the degree of over valuation may be different for *each combination* of the product and the competing country taken for the assessment. In other words, not only can rupee have no unique external value; it can and possibly would have hundreds of different external values—one different external value for each product—country combination. A detailed calculation of all the possible external values of rupee would give us a rather wide range of figures. In some cases like

* Because of their greater relevance for current policy issues we shall concentrate only on export commodities.

engineering goods, the degree of over-valuation thus calculated is bound to be exceptionally large. At the other extreme, in the case of items like jute manufactures and tea, we might find that the rupee is rather under-valued now. The entire range of values as would be revealed by this sort of statistical analysis would be indeed bewildering. A weighted average (weighted by the value of the export of each commodity) would give a comparatively simple and clear idea of the average over- valuation of rupee. It would be advisable to compile such data regularly.

Even on the basis of such data, we need not rush in to devalue. True, the value of rupee is not something sacrosanct: but nor is it something to be tampered with too lightly. It would therefore be wise always to fight doggedly as long as possible and take necessary measures to ward off the need for devaluation.

As already suggested, the ideal remedy is to cut the imports down to the level of the current export earnings. If we can do that we can forget all the nightmares of over-valuation, devaluation and all that. If there is no trade gap, there would be no compelling necessity to devalue.

We may note in passing that the existence of a chronic deficit in the balance of trade does not necessarily mean that rupee is over-valueed. Most probably, it would only indicate that total of our maintenance imports plus the import content of our investment programme is large than our normal export earnings, in which case the fault would lie not with the prevailing exchange rate of rupee but with the way our economy and its development are managed. We can blame the prevailing exchange rate when the imported commodities are cheaper than the domestic commodities; but we cannot blame the exchange rate when some of the commodities are just not produced in the country and have, therefore, to be imported. And, it will be generally agreed that our balance of trade deficit derives less from the former and more from the latter difficulty. In other words, in a fundamental sense, the chronic deficit in the balance of our trade has been largely a result not of any major overvaluation (before 6 June 1966) of our currency but of an imbalance in the structure of our economy. Hence a purely financial remedy (in the form of devaluation) is bound to fail.

Foreign Exchange Policy

Irrespective of the rates in the smugglers' exchange market, after the recent devaluation, the Indian rupee is clearly under-valued at least so far as most of our exports are concerned—a fact which is testified by the imposition of very high export duties. Gradually as the domestic inflation pushes up the export prices, this under-valuation may be wiped out in respect of commodity after commodity. Once the present under-valuation is wiped out, and if the inflation continues unchecked at the current rate, the rupee will gradully become over-valued. However slowly this might happen, this will be the likely pattern in coming years. A clearly visible indicator of this process will be the gradual reduction and the ultimate abolition of the export duties imposed along with devaluation. Since the rates of export duties can be taken as (measured in terms of the respective commodity) the removal of all export duties, as and when it takes place will signalize the disappearance of the current under-valuation of rupee. If the export prices continue to move up thereafter, the rupee will become *pari pasu* over-valued; this will create difficulties for our exports, which will have to be overcome by subsidies (open or hidden). In respect of each commodity, the magnitude of the prevailing subsidy will give a measure of the over-valuation of rupee in terms of that particular commodity (as already noted above, there is no unique measure of over-valuation).

What should we do when we reach that stage? Incidentally, this is same as asking: what should we have done before the 5 June devaluation?

When we know that our currency is over-valued, we should not rush to devalue. We should rather resort to the familiar system of import duties and export subsidies with a view to balance our trade. It is well-known that a widespread system of import duties and export subsidies tends to approximate to a *de facto* devaluation. This is quite true; yet this sort of *de facto* devaluation is certainly a lesser evil than the *de jure* devaluation and there is no reason why we should not prefer the former. The following are some of the advantages of the suggested system.

Firstly, the duty-cum-subsidy system is reversible, i.e., it is

much easier to reverse it than to reverse a *de jure* devaluation.

Secondly, devaluation is something fixed and rigid which cannot be altered from day to day; nor can it be administered in small doses. On the other hand, the duty-cum-subsidy system permits excellent flexibility from day-to-day and a selective operation for each item taken separately; it can also be administered in as small doses as required.

Thirdly, while the benefits of devaluation depend to a considerable degree on the play of various forces in the international market, the duty-cum-subsidy system due to its high flexibility and selectivity can be used, given the necessary tact and shrewdness in the operation of the trade policy, to maximize the gains to the country.

Fourthly, under the suggested system we save ourselves from the huge capital losses which we have to suffer as a result of devaluation on account of the real increase in the burden of our foreign liabilities which follows from it.

And last but not the least, the duty-cum-subsidy system does not subject the economy to a sudden and unsettling jolt which the devaluation invariably implies.

A subsidy can be given to each commodity as and when necessary. When subsidies become universal and (assuming that all imports will be subject to import duty) the *smallest* per cent of subsidy extended to any export commodity can be regarded as a measure of the justifiable quantum of devaluation. Thus, if commodities A, B, C and D are given 10 per cent, 20 per cent, 30 per cent and 40 per cent subsidies respectively, and if all imports also are subject to at least 10 per cent import duty, rupee may be devalued by 10 per cent and simultaneously all import duties and export subsidies may be simultaneously reduced by 10 per cent. This would be a rational mode of devaluation. Of all the criteria for devaluation suggested here, this one seems to be by far the best because it is most suitable to Indian conditions: it can not only help us to decide about the advisability and the timing of devaluation but also the quantum of devaluation.

Given the inflationary trend in the economy, the persistent deficit in our balance of payments and the difficulties experienced in expanding our exports, the demand or even pressure to devalue rupee once again will always be there with us. In view

of this fact, we badly need a consciously worked out strategy to cope up with these perennial problems on a continuous and permanent basis.

Before concluding this paper, I would like to suggest that in the analysis of the causes for the failure of our export drive, we in India perhaps over-emphasized the importance of the price factor in the whole situation. No doubt, price is a very important factor affecting the export performance of a country, but the export performance depends on many other factors such as availability of exportable surplus in the economy, dynamic and aggressive salesmanship, due attention to quality and particularly the uniformity of quality for repeat orders, adherence to stipulated shipping schedule, adaptability to the tastes and requirements of the clients in different countries, etc. A close study of the export performance of this country shows that all these factors are more decisive than the price factor, in relation to which alone the question of devaluation has any relevance.

Paper III

THE MECHANISM OF POST-DEVALUATION ADJUSTMENTS

P. R. BRAHMANAND

THE DEVALUATION of a particular country's currency has a number of automatic consequences. Let us assume that the home economy is working under conditions of competition, that countries related in trade do not follow suit, and that the home authorities do not neutralize the mechanism of the devaluation by the simultaneous announcements of various policy measures like the levy of steep export duties, reduction of import duties and expansive monetary and fiscal policies. Let us examine the consequences step by step.

Foreign Currency Prices of Exports

(*a*) Assuming that the home country produces a small portion of the world's supplies of the export of the different commodities, the foreign currency prices of exports remain unchanged. Even if the particular country exports significant portions of the particular commodities in the international market, so long as home supply conditions are unchanged, and the home economy does not possess buffer stocks of these commodities, the foreign currency prices of the exports will not be affected. But

this holds only in the short-run. If the home country is a leading, though not monopolistic supplier, the increased suplies will tend to affect the international prices in a downward direction; competition among the home-exporters will also work towards this. Over the longer run, the price and quota agreements will tend to be revised and the home country's share may go up. This tends to invite some defensive retaliatory action on the part of related countries. *Eventually the profit margin in the export trade will settle down to the pre-devaluation or near so proportions.* All this explains why devaluation cannot give any permanent advantage to the home country. It affords a breathing space (or interval) for the readjustment of economic policies and for re-designing the resource allocation pattern in favour of the export sector, so as to raise the productivity levels therein at a fast rate.

Foreign Currency Prices of Imports

(*b*) So long as the home country imports a small portion of the world's supplies of various imported commodities, the foreign currency prices of the imports will remain unchanged. If the particular country imports a major portion of the world's supply of any commodity, provided the home country reduces imports of that commodity, and, the exporting country has no alternative markets, and/or cannot increase the level of its domestic consumption of that commodity, or, raise the level of inventories in that commodity, the foreign currency prices of the imported commodity will remain unaffected. The home country may be importing a major portion of another country's commodity and using it as an input for its export commodity. In such a context, the country supplying the raw or crude material tends to levy an export duty. This will mean that the foreign currency price of the import will go up and the raised profit margin of the home country's export industry will tend again to shrink.

Freights and Insurance

(*c*) In so far as the foreign currency rates of shipping freights, insurance charges etc., are concerned, there is no reason to

expect a rise in them as a result of devaluation. Generally the foreign currency freight rates are fixed by international conference. Insurance charges of foreign concerns too will not be revised. But the rupee freight rates of home ships have excess capacity, or the home shipping industry can turn out ships quickly, a portion of the traffic will shift to the domestic fleet; the international business of the industry may rise. In this respect, invisible receipts may go up. But then substantial shifts may invite retaliations. A freight war may ensue. If the home insurance companies have the salaries of their international employees fixed in rupees, the rupee serviccing rates will go up. Yet, if the insurance industry has foreign branches, its business may go up. Its share of business *vis-à-vis* foreign or domestic companies may go up. If too much of shift occurs, retaliation will ensue through the agency of the foreign governments.

One may yet expect some rise in invisible receipts on this score. Similar observations would hold in regard to banking services. The share of home banks in business in these countries would tend to go up; but this will not tend to occur if the home banking or life insurance industry is nationalized.

Short-Term Capital Movements

(*d*) In so far as the home country shares only to an insignificant extent in short-term capital movements, there is no reason why short-term rates of interest in other countries should tend to be affected by devaluation. But some inflow of short-term capital may occur if the home country puts up its interest rate structure. There is no reason to expect speculative movements in the external value of currencies of other countries. Nor can we expect any changes in the flow of foreign private donations to the home country. To the extent that the devaluation measure restores confidence in the home country's currency, the flight of short-term capital would be arrested.

Remittances

(*e*) Inflow of remittances from the home country's nationals residing abroad may tend to go up; the outflow of remittances from the nationals of the particular country may tend to be

reduced. If the home country is already well known for its scenic beauty, historical monuments and for its luxurious holiday resorts, if the home country's customs and police regulations are not reputed abroad to be irksome, and if the travel and stay conditions are felt to be pleasant and the home country's environment considered peaceful, invisible receipts through travel may go up. The home country's citizens' foreign travel outlays may be reduced. Generally tourist recipts go up only over the long run. Whether the home country's tourist out goings get reduced depends upon whether scope for such reductions exists in a substantial manner.

Rupee Prices of Goods

(*f*) Whereas the external currency prices of the exported and imported commodities may remain unchanged, the ***rupee*** prices of imports will go up; those of exports will also go up. To the domestic producer, consumer or trader, the rupee earnings through the export of a bundle of a unit of given commodities goes up. The rupee prices, which he has to pay for the bundle of units of given commodities, which he imports, goes up. Similarly, the rupee prices of the freight, paid in terms of external currency goes up. The rupee cost of travel in other countries goes up. The rupee cost of banking, insurance and service payments made in terms of foreign currencies go up. To the extent that imported items enter as inputs in the manufacturing processes, the rupee prices of such manufactures may go up. The mark-up of prices may not be to the full absolute extent of rupee prices of imported articles (c.i.f.); on account of the higher rupee prices of the imported articles, the volume of credit required to transport a required article and to keep trading activities in being, becomes higher. Thus absolute interest payments are also higher. This would be true in regard to f.o.b. values of the exported articles as well. Even in regard to imported articles, which do not enter the production processes at all, the rupee prices will go up. This is because to the importer a raised rupee price means a rise in the level of working capital for transacting a given quantity of business. ***Hence, in order to replenish his stocks, he has to charge higher rupee prices for the commodity which he sells.*** To the extent that he

had more than normal stocks on hand, prior to the devaluation, he makes windfall profits. There may be other dealers or traders, who had below normal stocks; these will make windfall losses. Generally, some portion of business is always in process; this holds true for banking, trading and all other activities. Some contracts may have been previously entered into, without provision for price revision consequent upon devaluation. Hence, some producers or traders may make profits and some make losses. The problem becomes acute in regard to the export and import contracts, particularly i neonnection with rupee-payment areas. *In this connection, it may be advisable to set up a tribunal or jury which looks into cases of special hardships and compensates adequately the concerned parties.* In matters of trade, national interest requires contracts to be honoured. Despite their best wishes, private parties may not be able to do so, because of the limitations in their capacity to undergo losses. Hence, it may be worthwhile to set up a machinery to deal with individual cases. It is unconventional to treat the consequences of a possible devaluation as a normal business hazard.

(*g*) The above considerations also hold true in regard to producers who are committed to production contracts for export purposes, but who use imported commodities in their production.

Outward Remittances

(*h*) Devaluation reduces the foreign exchange value of remittances by foreign concerns or their branches operating in the home country. Yield or dividend rates may be fixed, and the exchange burden would tend to be reduced because of unchanged absolute *rupee* payments now equal to less of foreign exchange. If foreign technicians' salaries are fixed in rupee terms, or if pensions to foreigner are in rupees, the exchange remittances will be reduced with some real distress to the parties. However, there is nothing to prevent why foreign concerns or their branches should not step up the *rate* of remittances abroad. Their plough-back ratio may be reduced. Alternatively, if they are monopolists, they may seek to obtain higher profits by marking up the prices of their products. If they are part

of international cartels, prices of imported raw materials may be pushed up. Anyway devaluation need not necessarily lead to net advantages over the long run in this respect. The inflow of foreign capital may be affected. Foreign concerns may revise upward the salaries of their technicians fixed in rupee currencies. More of salaries may be fixed in terms of foreign currencies. Special compensation arrangements may be arranged in regard to the foreign employees.

Depreciation Provisions

(*i*) To the extent that a particular country's industries, as well as projects and other capital installations, depend upon imported machinery for replacement purposes, the capital costs of these industries as well as the projects goes up. The effect may be seen only over the long run, as the annually replaced requirements may be a small portion of the total. However, there is no doubt that the depreciation reserves of these concerns become inadequate. In order to meet the situation, amortization payments and depreciation rates may have to be raised. Thus, the prices of the products produced by the aid of these equipments will tend to go up. A second reason is that the prices of most constant-cost industrial commodities are determined by the *most recently established* units in the industries. As the rupee capital cost of these new units goes up, the price of the product tends to be higher on account of the higher depreciation and amortization charges. Thus, whether the industries and projects are old, or new, does not matter in so far as the price effect of devaluation is concerned. Over the long run, the raised capital cost of the industries and projects, automatically, leads to a rise in prices given the same rate of profit. It is immaterial here whether the projects are in the private or the public sectors. The price revision occurs quickly in the case of industries where most of the equipments have to be imported, and where depreciation and technological obsolescence as well as risks of accidental deaths are great (air and similar other types of transport).

Sectoral and General Price Levels

(*i*) To the extent that imported commodities are basic to

all production processes or enter as means of production in which other commodities are basic, prices tend to be marked upward more or less in a mechanical manner. Thus one may find that the price rise becomes general. It is not realized that the fundamental element in the process of price formation is from the side of capital (including inputs in the form of working capital). Any upward rise in the prices of basic goods automatically leads to a rising tendency of all prices. The wage rise that occurs consequent upon the rise in the basic goods prices is a secondary phenomenon and has no causal significance. To the extent that wages rise in proportion to the rise in basic goods prices, the theory of the fixed percentage rate of mark upon capital inputs would have been vindicated. In some countries like the UK, imported commodities directly enter the wage goods bundle. Here the rise in the sterling prices of imports due to devaluation affects expenses of production even of export commodities directly. In such countries, higher relative share of wages leads to a balance of payments gap.

Import Dependence and Prices

(*k*) Depending upon the extent of direct or indirect dependence upon imports, assuming that the imported commodities are limitational in the particular production processes, prices of different commodities will tend to be marked up. Commodities in which the direct and indirect and indirect import dependence is higher than the general average, tend to have their prices raised to a greater extent than those in whose case the extent of dependence is less than the average. If the above-average-dependence ratio—commodities are luxury consumption goods, or enter as inputs for luxury consumption goods, the demand for these goods will tend to be reduced; for, these commodities have substitutes in commodities which may have a ratio of dependence below theirs. The demand for these substitutes may tend to go up. As a result, the aggregate quantity of demand for imports absorbing foreign exchange may tend to be reduced.

Alterations in Domestic Structure

(*l*) The economy uses different types of commodities and in

various proportions in the production process. To the extent that imported commodities enter as production inputs, the relative prices of those commodities, in whose production the direct and indirect import dependence ratio is above the average, tend to go up, and relative prices of those commodities with the below-average ratio of dependence goes down. The production process, in which the latter type of commodities predominate now become cheaper in regard to commodities, which have a high ratio of dependence. Thus the production system, as a whole, will obtain a bias against dependence on imports.

The above mechanism also works in regard to travel, shipping, insurance, banking etc.

(*m*) Thus the rise in the rupee prices of imported commodities, and, of products, in which the former enter as inputs, leads to such alterations in the pattern of wants, and in the structure of production that aggregate demand for foreign exchange is reduced, or is maintained at a lower level than would have been the case otherwise.

Possible Reduction in Outputs

(*n*) In the above, we presume a framework of given aggregate monetary demand. Granted the above assumption, it does not follow that the prices of the commodities, in which imports constitute an important element as inputs, automatically tend to get marked up in the manner earlier indicated. There will have to be some reduction in the quantities of *outputs* of the high import-dependent-ratio commodities as also in the demand for imports of avoidable or postponeable consumption items. Industries utilising imports in a high proportion in their inputs tend to find a leftward shift in the demand curves for their products. Depending upon the new shape of the supply curve of the products in these industries, prices may tend to be marked up by less than the full extent. Whether the mark-up occurs to the full extent or less than that, depends upon whether the industry is operating under constant or increasing cost conditions. In the latter case, which may be more natural, the rise in the prices of products would be less than full extent of the mark-up induced by the rise in the rupee prices of imports.

Increase in Outputs

(*o*) On account of the increase in the demand for the products for a low rate of import-dependence activities, and of the changes in the industrial structure containing higher proportion of such activities, the outputs in some industries will be increased. This is because of the rightward shift in the demand curve for certain types of products. If these industries were operating under conditions of constant costs, the prices of these products will *not* tend to go up, but, if they are operating under increasing costs, prices of their products would tend to go up. If these industries are operating under diminishing cost, prices may go down.

Two Effects

(*p*) Thus, we have two sorts of effects to be distinguished. The first effect is due to rise in the rupee prices of imports. The second effect is due to the relative shifts in the demand among different industries. The first effect tends to raise the relative prices of some products more than those of the others. The second effect causes relative variations in the scale of activities in different industries, thus moderating or heightening the above effect.

Export Goods Prices

(*q*) Let us turn now to the export goods. The rupee prices of the commodities which are currently exported, or whose exports can potentially be increased, tend to be raised. Assuming that none of the imported inputs, directly or indirectly, enter into the expenses of production in the export commodities, there is no reason to expect a rise in the curve of expenses of production on the score of a rise in the rupee expenses of imports. But so long as resources are scarce, and conditions of full employment obtained, because of the potential operation of wage-goods gap, some rise in the cost of living may occur due to the rise in the prices of imports. This may lead to some rise in the levels of money wages of labour employed in industries producing export commodities. As a result, the expenses of pro-

duction may go up somewhat. Not all the margin between the new rupee price of the exports and the old expenses of production per unit will flow as profits. The diversion of supplies to the export front occurs because of the rise in the prices of export commodities. Given unchanged monetary demand, and to the extent that wage and consumer incomes do not rise to offset the rise in the rupee prices of exports, some reduction in the home consumption of export commodities, or of commodities which are capable of being exported, now occurs.

(*r*) To the extent that the exported (or exportable) commodity enters as a means of production in other industries, the prices of the products of the latter tend to go up. Thus in relation to other industries, in which the dependence upon goods or resources capable of being used internationally is less, the export industries find their domestic demand curve shifting to the left.

Resource—Shifts

(*s*) To the extent that the exported (or exportable) commodity utilizes some imported commodity as a raw material, and to the extent that such dependence is significant the expenses of production go up, and the margin of profitability as a result of devaluation is considerably less than in the case of other industries, which have a low ratio of import dependence. This naturally tends to exert a substitution effect *against* the commodities which have low import-dependence. The export industries, therefore, seek out alternative domestic sources of supply.

(*t*) Over the long run, the sector which produces the exported (or exportable) commodities seeks to attract resources from elsewhere, and this occurs partly at the cost of domestic consumption, and partly due to a higher rate of growth in the production of these commodities. With high profitability in this sector, productivity improvements may occur and be adopted here.

(*u*) On the import side, over the long run, the import of commodities should be reduced and the domestic structure must adjust itself to a lower ratio of import dependence.

Foreign Exchange Earnings

(*v*) Thus, given that the foreign currency prices of exports

and of imports remain unchanged, devaluation should tend to raise the foreign exchange earnings and to reduce the import bill in terms of foreign exchange. The success of the above mechanism depends crucially upon the ability of the system to reduce actually, or potentially, the level of home consumption of exported (and exportable) items, and of items of high ratios of import-dependence. *If domestic consumption is not reduced, efforts will be made to produce the forgone goods through methods and in forms which raise the commitment upon domestic resources.* Substitutes for imported goods or import-dependent goods are produced, and at raising levels of expenses. Similarly, substitutes for exported items are produced, again, at raising levels of expenses of production. This means that, so long as within the limits of the rupee prices of import or import-dependent products as well as of exports, profits can be made by domestic substitutions, the extent of the narrowing of the exchange gap is reduced.

Conditions for Efficiency of Mechanism

(*iv*) In order that the devaluation mechanism should operate smoothly, a number of conditions are necessary: (1) Not all the imports must be essential for production purposes, and should be capable of being economized without affecting the general production pattern; (2) The economy must have alternative production structures which can work with varying degrees of dependences on imports, and there must be freedom and opportunity to switch over from a high ratio of import-dependence structure to a low ratio of import-dependence structure; (3) Relative prices of different goods must be free to vary; (4) The export (or exportable) commodities must have a low ratio of dependence on imports; or, alternatively, there must be various structures of production of exports, in which different degrees of import-dependence can be envisaged; (5) The exported (or exportable) commodities must not be production necessities; (6) Even if some of the export commodities are production necessities, it should be possible to switch over to production structures which make less use of these commodities; (7) There should be freedom of resource movement in favour of the export sector and against the import-dominated sector; (8) The

economy should avoid raising the level of its domestic consumption and its commitments upon resources going for the export sector by devising substitute activities or industries catering to consumption; (9) *The monetary and fiscal system must be neutral.* This means that the aggregate monetary demand should be kept stable, or only be allowed to change at the rate at which total supplies of basic goods, or basic production capacity is growing. This means that the economy must be allowed to tolerate fractional unemployment in local markets, and the monetary and credit system must *not* be allowed to expand. We also presume that whatever commitments are made because of the budgetary impact of devaluation will be made good only through taxes, *and* of a *neutral* type; (10) There are of course other disturbances, shocks etc. such as climatic failures etc., which may upset the working of the mechanism or may not give enough scope to work out itself.

We have examined the conditions for the success of devaluation from a trade angle. Our observations hold true also regarding the invisibles account as well.

Need of Community Support

(*x*) The very stringent conditions necessary for the success of devaluation makes its efficacy rather doubtful unless the support of the community exists for the creation of these conditions, the authorities are clear in their thinking, and firm in their decisions. Generally, the initial gains of devaluation are dissipated by expansive fiscal, monetary and credit policies. This itself may be encouraged by the pressure of business and of trade unions. The domestic economy may not get the freedom to reallocate the resources. The tax system may not permit relative profitability rates to be altered. There may not be freedom for the movements of prices. Labour transfers may become difficult. Consumption pressures may operate so strongly that the foreign exchange gap is not narrowed at all. Persistence of inflation after devaluation means that the *extra saving* needed in order to make the devaluation successful is prevented from forthcoming. If the community consensus is not obtained, devaluation becomes an invitation for further inflation. It is thus that very soon the initial advantages disappear. If inflation is the cause

of devaluation, obviously persistence of inflation *after* devaluation, simply means that community is not prepared to make those structural changes, which will lead to the narrowing of the foreign exchange gap. Hence, a further devaluation becomes inevitable and so it goes on in the form of an endless cycle with the sequence, inflation-devaluation-inflation-devaluation. During every period of inflation, the currency becomes over-valued, and pressures are mounted against devaluation. No sooner devaluation occurs, pressures are mounted for raising the scale of monetary demand, until a further devaluation becomes inevitable.

Need for Reversal of Inflationary Policy

(*y*) The central condition for the success of the devaluation is obviously the *reversal* of the policy of inflation and the creation of an atmosphere more favourable for the speedy development of the export sector, for a steep curtailment of imports, and for an environment of savings promotion. A neutral monetary-fiscal system achieves this objective. Thus, the next step from devaluation is the introduction of a neutral monetary and fiscal system. The process of economic planning has to become an element in the above framework, and not become a powerful engine of inflation.

Paper IV

DEVALUATION: FISCAL AND MONETARY ASPECT

D. T. LAKDAWALA

IN DISCUSSING the fiscal and monetary problems connected with devaluation, there are really two different aspects to be considered—the specific issues arising directly from the act of devaluation and the other steps intrinsically connected with it, and the old controversies in these fields which devaluation has brought out in sharp focus once again in a slightly different context, unfortunately often without throwing much further light. The two undoubtedly get blurred into each other, and the first by itself do not lead to policy guidance. But, for the sake of convenience of economic analysis and arguments, it is better to keep a sharp distinction between the two. This paper only deals mainly with the first aspects.

Budgetary Effects

The effects of devaluation on the receipts and expenses on the revenue and capital accounts of the Central Government depend, to some extent, upon the assumptions made in several spheres. The estimates regarding the consequences have, therefore, to be taken along with the details of the calculations.

There are only a few budgetary items on which the consequences are easily ascertainable. On the revenue account on the plus side, the receipts from Customs' duties will increase in two ways. Along with devaluation, export duties have been levied on about a dozen important items accounting for three-fifths of our exports. These duties are estimated to fetch Rs. 125 Rs. 150 crores a year.* The logic of devaluation demands that these export duties should be flexible and should be reduced or eliminated soon as this becomes necessary in the interests of export promotion. The export duties may have been imposed because the external demand is inelastic at the moment, and a fall in foreign price to the extent of devaluation may have the effect of reducing the foreign exchange receipts. They may also have been levied, because the exportable surpluses cannot be increased immediately by an increase in production or/and decrease in consumption. This cannot be assumed to be a permanent phenomenon. Propaganda and promotion efforts may expand the foreign demand; production can be increased over a period; substitution in consumption may become possible; consumption habits can themselves be changed; in some cases, the rise in domestic costs may slowly eat into the gap between the prevalent foreign and domestic prices. It may, therefore, be necessary to keep in perpetual readiness to change these export duties without any regard to revenue considerations. The actual proceeds during the year may, therefore, be substantially less than the estimates. Unlike in the case of exports, where the existing duties were marginal, the pre-devaluation import duties were substantial and largely ad valorem. Devaluation, by increasing the rupee prices of imports, would increase import revenue earlier estimated to yield Rs. 567 crores in 1966-67. Along with devaluation, however, some reductions in the import duty structure were announced. The duties on primary raw materials were reduced from 50 per cent to 27½ per cent, those on machinery from 45 per cent to 27½ per cent, on agricultural machinery from 25 per cent to 15 per cent. on other raw materials and intermediates from 70 per cent to 50 per cent, and on consumer goods from 110 per cent to 100 per cent. Since

* In this as well as other items, since devaluation was resorted to only in June, the effects will only be on the remaining ten-month period.

the reduced duties would be calculated on enhanced rupee prices, they would work out somewhat less in the case of the first three groups and higher in the case of the last two. Looking to the Indian trade composition, no substantial revenue change from imports would be expected either way. The central excises would somewhat diminish, as in the case of kerosene and fuel, the duties were to be so adjusted as not to enhance the prices to the domestic consumers. There was the wider question of the effects of devaluation and a consequent defreezing of aid, etc. on economic activity. If industrial production increased and the economy gathered momentum, there would be an all round increase in revenue receipts from income-tax, central excises, etc. Ignoring the last, one could still say that by and large, the revenues of the Central Government were likely to benefit.

On the expenditure side, there were also some pluses and minuses. The interest on debt raised outside India which was estimated at Rs. 94 crores in 1966-67, would now cost more (except for that part which would only be due in rupees). On the capital side, the repayment of foreign debt was expected to cost Rs. 121 crores next; it will mean higher rupee costs unless the repayment schedule is revised. Since imported food has to be sold at pre-devaluation prices, food imports would need large subsidies. As far as PL 480 imports are concerned, the expenditure on food subsidies would be largely counteracted by the greater rupee value of PL 480 imports on the capital receipts side. But the commercial imports of foodgrains and the freight would mean an uncompensated increase in expenditure. The decision to do away with tax credit certificate schemes for certain exports will mean substantial saving from the full provision of Rs. 20 crores; the sugar part of export subsidy of Rs. 20 crores may also be done away with. The maintenance imports on public account not financed by A.I.D. Loans will cost Rs. 70 crores more. The upward increase in the non-negotiable rupee securities with the I.M.F., I.B.R.D., etc., would be only a book-entry. The receipts of foreign loans (other than PL 480) estimated at Rs. 460 crores would only make an entry difference, where the expenses were also on Government account; but where the sales were made to private parties, this would lead to a sizeable gain. With the $850-900 m. dollar non-

Project aid now in offiing from the free world, foreign loan receipts even in foreign currencies may show a significant increase.

Taking all items into account, the Finance Ministry has made the calculation that the direct impact of devaluation on the Central Budget would not be significant either way. It seems that the calculations here have been made on the original loan figures and on only about Rs. 150 crores being made available to the private sector. In the event of such aid being larger as it now seems possible, the fiscal impact on the Government budget may be more favourable from the overall viewpoint. This is on the assumption that there will be no significant tax or expenditure policy changes, and that in particular, large wage and salary increases will not be allowed by way of settlement of past or present claims.

Demand for Tax Concessions

Devaluation has, however, brought in demands for certain concessions in taxation, some of which deserve favourable the foreign exchange component of their investment by borrowing in foreign exchange or buying on a deferred payment basis. The instalments towards repayment of the unpaid part of these loans will now cost more as the commitments are in foreign exchange. There has been a persistent demand from industrial quarters that since the additional amount needed is really by way of the rupee revaluation of a capital liability, it should be regarded as additional investment, and be allowed the usual development rebate and depreciation charges; it would otherwise be difficult for the industry to write off these amounts as losses. A concession of this character will mean a fall in revenue from direct taxation.

A point has been made that heavy excise duties on commodities have been one of the important contributory causes of price increases, and a policy of price stabilization notwithstanding the pressures consequent on devaluation would be helped by a substantial reduction in these duties. While there is no doubt that given some leeway in production capacity, a reduction in the excise duties on a particular commodity will have the effect of reducing the price of that commodity, the effect on the gene-

ral price level via the budget surplus will probably be adverse, and on the whole, of greater consequence. Substantial reductions in excise duties are only possible on the assumption that there would be a sizeable decrease in public investment or/and public expenditure.

Monetary Policy

As far as the monetary policy is concerned, there is one vital question arising out of devaluation—the financing of the likely increase in imports and its rupee value consequent on the developments arising out of devaluation. Hitherto, during the period of the Third Five-Year Plan, we had been receiving foreign aid (apart from PL 480) at the rate of Rs. 500 crores a year. This was mainly Project-aid, only a part of the aid—less than one half—was available for maintenance imports. The expenditure on the latter imports was much larger, during the Third Plan, it was estimated at Rs. 3,650 crores to Rs. 3,800 crores. A large part of this expenditure was met out of export earnings. The new non-Project aid thus marks a substantial stepping up in this direction. The question of Project-aid during the Fourth Plan remains to be settled, but some assistance can be counted upon even here. A USSR programme of aid has been tentatively announced; in the field of agriculture and allied fields at least the US can be relied upon to take a sympathetic attitude. The World Bank and other nations also will lend for limited projects. In the immediate period, it will, therefore, be possible to finance additional imports on a large-scale. Our capacity to find the complementary domestic resources and the need of conserving foreign exchange resources as the non-Project aid may not be repeated will remain severely limiting factors. The question of the rate of utilization of foreign aid will, therefore, remain uncertain, and the various monetary questions connected with it. One can only say that as far as the present indication go, the level of imports will be larger than the previous years.

The financing of the old imports at the enhanced rupee prices and the additional likely imports are likely to raise some acute questions for the monetary authorities. Some method of enabling the private sector to finance that part of the imports which will go into it has to be found; the credit for capital rupee receipts

for this will be taken by the public authorities. The fuller utilization of domestic resources which the additional imports will make possible, will also call for more credit. The increase in rupee exports (which immediately will not show a great increase in quantity, as well as an increase in prices to the same extent as import prices), will also, to some extent, need additional wherewithals to the system. A better agricultural season may call for more finance. At the same time, the need for price stabilization has been more pressing, and devaluation has added to the price-raising forces. Additional credit can only be provided to the extent necessary to facilitate additional production and to the extent it really comes about. The rest will have to be largely found by a diversion from the non-priority sectors to the priority sectors.

A part of the requirements will be really for the purposes of the non-working capital, and should, therefore, be legitimately financed by funds obtained from the capital market. In fact, it has been shown that in the past, a part of the substantial bank credit increases has been used for financing of capital assets. In a way, this was forced by the depression in the capital market. It may be argued that if devaluation etc. succeed in reviving the capital market, the latter can be relied upon to supply the need for additional funds. The conditions that led to the stagnant capital market earlier and the steps necessary for its revival are a complicated subject which may not be gone into at this juncture. All that need be observed here is that even if the market is revived, the funds for industry may come not from increases in savings, but from bank deposits, which then may dry up another non-inflationary source of bank credit or of deposits with industry. Increased production and export earnings will lead to larger bank deposits, but the basic problem will still remain.

A word may be said here about the limitations that monetary policy has hitherto suffered from. It had to contend with a large amount of credit to the Government beyond its control and also substantial credit to the public sector almost beyond its control. It could only keep in check credit to the private sector, which also become difficult because of the many inter-connections between the Government and the private sector, and the fact that the targets of industrial expansion in the private sector proved overestimates. Now with a better general climate the Reserve

Bank may have wider scope for working out a more comprehensive and effective credit policy in the direction of narrowing of the spread 'between the rate of monetary expansion and that of growth in output.'

Paper V

DEVALUATION AND PRICE STABILITY

H. T. PAREKH

No SURGICAL operation can be bloodless; much less, a major operation like devaluation. It can hardly fail to leave scars on the economy. However, among the many bold decisions taken by the present Government in its short period of existence, both in the political and in the economic field, the action to devalue the rupee may be regarded as the bravest. It is an irreversible decision. We have to live with it and set it to the best advantage.

In one sense, devaluation is an admission of defeat of the policy hitherto pursued. In another sense, it is an act of faith so far as the future is concerned. Nevertheless, if devaluation is also an act of courage, the success of the measure depends upon many other acts which have to go with it. Devaluation to be successful demands discipline.

Devaluation is a long-term measure and its success or otherwise will require time to be felt. But what happens to the economy in the immediate future is vital for its ultimate success. The fear in the heart of the people is that it will raise prices further. Devaluation is a consequence of inflation. Will it also be a cause of further inflation? If, therefore, we succeed in keeping prices of essential commodities from going up, we will have won half the battle.

The Government has begun well by announcing a firm policy that prices of essential consumer goods like food grains and kerosene will not be increased, even though this would require subsidy out of public revenue. This policy must be firmly adhered to. Public opinion is also being mobilized by the Central and State Governments to hold the price line. This, if it is to be more than a slogan, can be achieved only with the whole-hearted support of the business community. In effect both the Government and the businessmen should be ready and willing to absorb such losses as are incurred without trying to shift them on the taxpayer or the consumer by raising taxes and prices. The real danger lies in that both the Government and the trader, while paying lip sympathy to hold the prices, would attempt not to bear any burden themselves and both may try to pass on the increased burden to the general public.

Next to food articles, the prices of textile goods affect the consumer vitally. The textile industry, in so far as it depends upon imported cotton and its effect on the price of indigenous cotton, would want to raise the prices of textile manufactures, particularly of fine and superfine varieties. (The prices of textile chemicals may also have a similar pull.) Prospects of a liberal supply of imported cotton under P.L. 480 would help to keep down this tendency. With luck, the prospects of a good monsoon and a good cotton crop might help to keep down the prices of indigenous cotton. Hopefully, there might be market resistance to a rise in the prices of textile manufactures' which are already unduly high. Should these factors, however, fail to hold prices, the Government should announce in advance that it will counteract any possible rise in prices, if necessary, even by some reduction in excise duties on those varieties of goods which would be affected. The trader and the manufacturer, if he is to keep clear of hoarding and profiteering, must be impressed by the Government's firmness and determination in checking any price rise of essential goods. He understands no language better than that there would be no opportunity to reap extra profit. In that event the manufacturer will also endeavour in other ways to absorb the rise in the prices of his raw material.

Government Initiative

The initiative for holding the price line rests a great deal with

the Government because taxes like customs, excise duties and, sales tax constitute a substantial part of the ruling price of textiles and many other articles, which the Government can easily alter. Once it is established that the Government would even resort to tax cuts to achieve its objective of price stability, the effect would be salutary. The actual tax cut may not even be necessary once the people realize that the threat of a tax cut is real. However, the people must be convinced of the Government's earnestness and determination. It lies with the Government to prove this to public.

What the Government has done to keep down the prices of petroleum products, it must be ready to do for other products of essential consumption. Once the psychology of runaway price rises is pierced, the task of holding prices would become easier. In times like the present, revenue considerations should weigh less with the Government than the primary task of preventing any rise in the cost of living and in the cost of production. The Government should endeavour to hold the prices of all important commodities because both the cost of living and the cost of production should be prevented from going up. Unfortunately, there is very little evidence yet of the Government's willingness to forgo revenue, even for the sake of price stability. This is the real touchstone by which the Government will be judged. It is true that we should not hold a mechanistic view about prices. Not all prices can just be held at the current levels because consumer goods, capital goods and luxury goods cannot all be judged by the same yardsticks, but as a strategy it will be desirable to allow no price rise for 3 to 6 months. Later a body like the Tariff Commission could review essential prices where there is a *prima facie* case for some price increase.

This would mean that the Government should not be satisfied with the changes in import duties announced on the day of devaluation, which are done on an *ad hoc* basis from the revenue angle only and not on basic economic considerations. This is an important moment to review the structure of both import duties and excise duties. If this revision is done quickly from the angle of prices a new trend towards lowering of prices could be generated, which would also assist the country in its effort to export more. Under today's circumstances really deflationary effects could be generated by suitable lowering

of the structure of indirect taxes.

The following is the revised structure of import duties:

	Old rates (including the regulatory import duty of 10%)	*New rates*
Machinery	45	27½
Primary raw materials	50	27½
Other raw materials and intermediates	70	50
Agricultural machinery	25	15
Consumer goods	110	100

The post-devaluation reduction in the rates of import duties, particularly on capital goods and primary raw materials, is based on the consideration that the quantum of tax burden on importers should not be higher than what it was before devaluation. This would also ensure the same amount of customs revenue as before for the Government. As an initial measure, this step was the right one to take. However, once the Government begins to have a better measure of the impact of devaluation on the economy, it must immediately proceed to revise the rates of import duty with the primary object of lowering prices and at the same time giving a boost to increased production within the country. Since in the final analysis prices can be held only by increasing supplies, governmental action should be such as to lower the costs of production and encourage production at full capacity, particularly in view of the anticipated liberal aid to import more raw materials, components etc. The Government must seize every opportunity to give a lead to lower costs and prices. There are a few industries suffering from idle capacity due to lack of demand, e.g., electric meters cables, glass, etc. Here there is a strong case for removing excise duties to stimulate demand and production.

Increasing Exports

If an assault on the price front is to stabilize the economy and

to prevent it from sliding down once again in regard to inflation, the long-term objective has to be to step up exports and narrow down the balance of payments gap. Devaluation has opened the doors for an offensive to augment our exports by improving India's competitive position in the world market. In several fields *de jure* devaluation has only replaced *de facto* devaluation (in the form of export subsidy and import entitlement) of the earlier period. However, devaluation has brought out in the open the real issues and considerably reduced the price disadvantage which Indian goods had in the World market. The results can be felt only slowly. In the neighbouring markets of Ceylon, Malayasia, Indonesia, the Middle East, East Africa, it should be possible for India to make better headway in export. For example, there is no reason why in the neighbouring markets of Burma, Malayasia, Ceylon, etc., India should not capture a large part of the import trade of these countries and weaken the hold of such competitors as Japan. A wide variety of imports into these countries can flow from India if a determined drive is made to take full advantage of the present situation.

Stability

A new stability is returning to Indonesia. India should seize this opportunity by initiating special trade agreements with her, selling her many manufactured products against mineral oil, rubber, and other products which Indonesia exports. India should make a bid to sell sugar, cement and paper plants and machinery, and machine tools by giving necessary credit on easy terms. Indonesia, with its higher degree of inflation than in India, should offer a good market for Indian manufactures, particularly of capital goods, if we are ready to give suitable credits on a long-term basis and at low rate of interest, just as Russia is selling a Bhilai or a Bokaro steel plant on a 12-year credit and buying from India out of the proceeds consumer goods such as textiles and shoes; so also should India work out credit terms for exporting capital equipment and get paid in rubber, spices, oil, etc. which Indonesia can offer and which India needs. The report that Burma is willing to sell more rice against larger Indian exports is a heartening sign of a greater

exchange of goods between India and her neighbours. For example, Indian coal should now have an edge over South African and Chinese coal in the nearby markets. Should relations between Pakistan and India improve and the Tashkent spirit be reflected in a possible agreement for larger trade, there will be additional gains to the country both through larger exports and better availability of essential supplies of raw jute, cotton etc. which Pakistan can offer.

Hitherto, Government fiscal policy has been revenue-oriented and not price and production-oriented. Devaluation provides the momentum to change the basic objective of fiscal policy to lowering and holding prices. Devaluation also provides the basic stimulus to an export-oriented policy, with particular emphasis on capturing the export markets of such neighbouring countries as Burma, Ceylon, Malayasia and Indonesia where India has a competitive advantage over other countries. This can bring handsome and enduring gains to India's balance of payments and to the Indian economy.

Price Front

Apart from the price and export fronts, what impact will devaluation have in the immediate future? For instance, what will be the effect on the money market and the capital market? The economic stagnation of the last two or three years has been accentuated by the policy of excessive credit squeeze and the depressed state of the stock market. Strangely, the climate of general price inflation had left the capital market untouched which, on the contrary, suffered a severe depression. It would perhaps be worthwhile attempting to forecast what will happen in these fields, because this will have an important bearing on the state of the national economy.

The first question to ask is: Will devaluation result in a burst of business activity which would increase the demand for bank credit? Thanks to the policy of stopping import licences altogether for the last one year, inventories of imported goods have run down, causing some ease in the credit situation. The recently announced new policy of liberal issue of import licences will no doubt alter this situation but devaluation has made imports much more expensive. Apart, therefore, from the fact that

the actual issue of licences will itself take some months, importers will be in no hurry to import goods (except in certain categories) which are much more costlier than before and, therefore, would require larger rupee financing. Under these circumstances, it is unlikely that there will be any sudden activity exercising pressure for bank credit. The build-up of inventories will be slowed down further because the ready availability of imports would itself result in a phased import programme. On the other hand, exports are likely to be stimulated as a result of devaluation, though this must be a slow process. However, larger exports would have the effect of easing the credit situation, just as larger imports exercise a deflationary effect on the money market.

Further, there is noticeable an upward tendency in bank deposits which have risen considerably this year. It looks as if this trend will continue, with the result that there will be a steady increase in the supply of funds with relatively low demand. From available indications, it appears that the present comfortable state of the money market is likely to continue. We are not likely to witness that level of credit stringency as that of last year, even during the next busy season.

However, recent press reports and the indication of discussions between the Reserve Bank and the commercial banks suggest that the authorities view the situation differently and are putting further pressures on the banks to restrict credit. This is perhaps a misreading of the situation and taking a panicky view. It would come in the way of increasing production, which is the need of the hour and for which the policy of import liberalization has been instituted. The trade, industry and the banking world are taking one view of the situation, while the authorities are taking the opposite view. Mr Asoka Mehta talked of a meeting of minds when he went to the World Bank. Is not the need for a meeting of minds even greater in India between different sections of the community and the Government?

It is now generally recognized that the rupee resources position of the Government is not likely to be adversely affected by devaluation. Collections for new export duties and additional customs revenue resulting from increased imports as compared with last year will provide adequate funds for the Government to meet the additional rupee liability for servicing our

external debt. Moreover, the Government ways and means position may possibly improve as a result of the import liberalization policy because the large non-Project aid under which import licences are being issued will involve an accretion of rupee receipts to the Government against cash licences issued to importers at the current rate of exchange.

The expectation is that not only will the money market remain fairly comfortable in the present slack season, but it will not also be very tight in the following busy season. This would mean that there may be some softening of interest rates. It will be beneficial if some competition among banks for making loans is re-established which will bring about some lowering of the advances rates of banks from the present high level of 9 to 10 per cent. Just as there is need for reducing costs in all directions, the banking industry can also assist by the lowering of the cost of credit by, say one per cent. It is unlikely that the authorities would at present take the step of lowering the Bank Rate even by one-half or one per cent; but there certainly is a case for reducing banks' deposit rate from 91 days to one year from the present level of 5 to 6 per cent, to 4 to 5 per cent, which is more in line with the logical pattern of short-term interest rates. The existing deposit rate of 4 per cent from saving deposits would fall in proper alignment if term deposits from 91 days to one year carry the rate of interest of 4 to 5 per cent, instead of the ruling rates of 5 to 6 per cent. If banks can do this, then the cost of borrowing will go down to that extent, enabling them to lower their advances rate as suggested here. The current deposit rates for long-term deposits offer an avoidable inducement to savers to keep their savings in term deposits, whereas they should be attracted to invest such savings in securities.

Capital Market

Devaluation would have a most fruitful result if it can help in restoring buoyance to the capital market. Every possible effort should be made to revive the capital market, for on this depends the health of the economy and its ability to produce more goods. Since the present Finance Minister assumed office, stock prices have risen by over 10 per cent, which is a great gain in the re-

turn of the market to normalcy. The budgetary step in connection with removing impediments to bonus issues has greatly helped to instil a new air of optimism. Devaluation is the next major step which shows signs of improving the tempo in the stock market. The market is gradually returning to normal after many years of stagnation. The day may not be far off when new capital issues will again begin to attract the investors' attention. The slowing down of the economy has resulted in the drying up of capital issues by new companies. Shares of new companies floated about five years ago, which had gone down in values, are now reviving. Another general rise of 10 per cent in share values, for which there are indications, will bring about the right climate for the successful issue of new capital.

This process will be greatly assisted if the Government, taking the opportunity provided by devaluation, makes a fresh examination of its fiscal policy to ensure its success. In its search for resources, the Government is losing its objective of price stability. It is this priority of objectives which the Government should re-examine in order that devaluation may succeed.

Paper VI

DEVALUATION AND FUTURE PRICE PATTERN

KERSI D. DOODHA*

ADDRESSING A MEETING of industrialists, bankers and exporters at Rajaji Hall in Madras on June 17, 1966, Mr Sachindra Chaudhuri, the Finance Minister, said, "the Government had taken a decision—'good, bad or indifferent'—and the only question for consideration now was how best we can avoid the difficulties that may be created by this."[1] One of such 'difficulties' overtly recognised by official circles relates to the future behaviour of prices. Mrs Indira Gandhi on the programme *'Person to Person'* referred to it. She confided, "I am deeply conscious of the fact that prices have been rising and have risen still further in the past few days. There is little justification for any increase in prices of items without any import content."[2] To this Dr V. K. R. V. Rao added a rider. He explained, that "Even in the case of goods involving foreign components, the rise in prices

* The views expressed herein are those of the author and not necessarily those of the institution to which he is attached.

[1] Quoted in *Times of India,* 18 June, 1966, p. 1.

[2] 'Person to Person', a broadcast to the nation on 12 June, 1966 reproduced in *Times of India,* 13 June, 1966, p. 7.

should be proportionate to the percentage of imported content."[3] On the other hand, Mr P. C. Bhattacharyya, the Governor of the Reserve Bank, felt that neither opinion is totally correct. In his view, "One effect of devaluation is to raise the rupee cost of imports. However, this need not necessarily result in an immediate rise in prices of all imports or goods to actual users. Even in the long run, it is not necessary that the prices of imports to actual users for commodities which use import components should go up to the full extent of devaluation. In many cases, the resumption of flow of aid should lead to a step-up in industrial production to a fuller utilisation of capacity. In other cases, such as those where imports were formerly arranged through use of entitlements bought at a premium, the impact of devaluation might well be to lower import prices. However, after making allowance for these factors, some price increase for imported articles is to be expected."[4]

From these observations, the proposition on expected price behaviour suggests *an increase in the prices of goods containing imports in proportion to or less than the import content*. However, prices of goods not containing imports should not rise. It is the purpose of this paper to examine the validity of this hypothesis.

IMPACT OF DEVALUATION

First let us be clear on the meaning of devaluation. When we devalue, what we in practice do is to bring about an equilibrium between the internal prices of goods and services, with those prevailing in the international markets. We at the time of announcing the devaluation have done nothing to bring about a change in the accounting system at home. As a consequence, the future pattern of prices becomes a function of the extent of

[3] V.K.R.V. Rao, *Effects of Devaluation,* public speech at Sapru House in New Delhi, given on 26 June, 1966 quoted in *Economic Times* on 27 June, 1966, p. 1.

[4] In his address on the occasion of 'the 13th Anniversary of Bombay Bankers' on 29 July, 1966. Reprinted in the *Reserve Bank Bulletin,* July 1966, p. 748.

devaluation and the prevalance of other factors governing the determination of prices. Let me take devaluation first. We have devalued the rupee in terms of cross-currencies by 57.5 per cent. To this extent our exports have been made cheap and our imports costlier. In normal course, the earnings from exports therefore should substantially rise and the value of imports considerably fall. This would enable us, it is hoped, to close the gap in international trade in about three years time.

A. *Movement in Exports*

Will our exports increase? In answering this question, mere consideration of price will not give us an answer. We have in addition to take into account other factors such as elasticity of international demand for our exports, supply elasticity of exportable items (export surplus), presence or absence of export promotion schemes, the future pattern of export incentives and the parameters of the industrial appartus in the form of contractual obligations. Insofar as elasticity of foreign demand is concerned, it has been pointed out, that up to 60 per cent of our total exports are traditional in character and have an inelastic foreign demand. A lowering of their prices, other things being equal, will not lead to an increase in their volume. Actually, devaluation in their case may be expected to lower the export earnings. Such major items from Table 1 may be identified as tea, spices, hides and skins, cotton raw and waste, leather manufactures and cotton textiles.

Export Duties

Knowing that bulk of our exports are demand inelastic, the Government acted swiftly to neutralize windfall gains accruing to importers. With devaluation, it simultaneously announced the imposition of countervailing export duties on tea, jute manufactures, oilcakes, unmanufactured tobacco, raw cotton and waste, mica, hides and skins, coir and coir manufactures, and leather (tanned and untanned). From this, it is apparent, that about 55 to 60 per cent of our exports are not likely to benefit from devaluation.

Further, in case of traditional items, the supply is inelastic, since they depend on developments in agriculture. The current

Table 1

PRINCIPAL EXPORTS OF INDIA

(Rs. in crores)

	Commodity	*1960-61*	*1961-62*	*1962-63*	*1963-64*	*1964-65*	*1965-66*
1.	*Agriculture*	213.82	229.01	252.83	272.39	286.57	236.28
	a. Cashew	18.91	18.17	18.36	21.41	28.06	27.10
	b. Tea	122.61	121.40	128.22	122.21	125.80	114.84
	c. Spices	16.62	17.51	13.79	16.02	16.79	23.15
	d. Oilcakes	14.30	17.32	31.79	35.37	38.51	33.38
	e. Sugar	3.28	15.33	17.93	27.10	19.20	11.34
	f. Tobacco (unmanufactured)	14.61	14.05	18.00	21.09	24.25	19.26
2.	*Crude Materials*	112.06	118.33	111.08	131.98	139.46	130.84
	a. Hides & Skins	9.46	8.22	10.71	9.60	9.07	10.32
	b. Cotton Raw and						
	c. Iron Ore	17.03	17.41	19.83	36.40	38.76	42.10
	Waste	11.56	20.35	17.04	16.84	14.23	12.72
3.	*Mineral Fuels, Lubricants and Related Materials*	7.41	5.90	6.48	9.76	12.73	8.29
4.	*Edible Oils*	9.80	6.49	13.65	20.60	7.42	4.55
5.	*Chemicals*	7.19	7.83	7.84	6.90	9.86	10.24
6	*Manufactured Goods*	263.34	269.78	266.69	319.48	348.83	343.30
	a. Leather	24.97	24.45	22.63	26.38	27.43	28.00
	b. Cotton Textiles	57.55	48.26	46.21	54.34	58.58	57.47
	c. Jute Textiles	131.72	140.49	152.12	153.55	179.47	182.85
	d. Iron & Steel	9.76	9.88	2.28	3.61	11.19	14.28
7	*Machinery & Transport Equipment*	7.19	4.74	0.47	7.06	9.30	10.82
8.	*Total Exports*	642.32	660.34	685.48	793.24	838.70	809.55
9	*Goods with Import Entitlements*	n.a.	94.00	113.00	114.00	172.77	168.55

SOURCE: *Reserve Bank Bulletins*

monsoon is weak, more than 50 per cent of our land area having received sub-normal rains. Nor is the productivity of agriculture likely to rise rapidly, to neutralize the growth in population and thereby generate an exportable surplus. For instance, this is the case with edible oils, cashews, oilcakes, cotton and tobacco, where demand is strong, but supply fairly inelastic. In case of a fairly good export earning item like iron ore, the bottleneck to increased exports will come from the absence of infrastructure in the shape of transport facilities at the mines and port terminals.

Further, in total exports, a substantial quantity moved prior to devaluation because of various export incentives, *inter alia*, in the form of import entitlements. For instance, the amount of total exports qualifying for import entitlements was Rs. 94 crores, Rs. 113 crores, Rs. 114 crores and Rs. 169 crores in 1961-62, 1962-63, 1963-64 and 1965-66 respectively. In the post-devaluation period, export incentives were abolished. This had an adverse impact on our capacity to export. Formerly, many exporters exported below cost, knowing fully well, that the loss so incurred would be more than compensated, by the premium to be paid in securing imported raw materials, or the premium to be received on import entitlements. It is said that after devaluation, many exporters pulled out their goods from the port limits in view of the cancellation of incentive schemes.

Restoration of Incentives

Consequently, there was a clamour for the restoration of incentives. For instance, the engineering goods exporters complained that for over a month, after devaluation, exports were at a standstill owing to the delay in announcement of alternative incentives. According to Mr R. L. Rajgharia, Vice-Chairman of the Engineering Export Promotion Council, "Benefits of the devaluation had remained illusory as far as the engineering industry was concerned. Already, advantages of devaluation had been eaten away by the increase in costs of imported raw materials."[5] In case of cotton textiles, it was claimed that because of state assistance in other countries, it was difficult for us to compete in international markets. Similar was the complaint of the

[5] Quoted in the *Financial Express*, 11 July, 1966, p. 5.

gem and other industries. Probably, as a result of these representations and the promise by one of the Cabinet Ministers to do something positive in this regard, an export incentive in the form of direct cash subsidy ranging from 10 to 20 per cent of f.o.b. value of exports was announced on August 12, 1966. The items qualifying for aid were steel, sugar and engineering goods accounting for about 25 per cent of total exports.[6]

Finally, in spite of direct cash subsidy, it is doubtful to what degree we will succeed in reaping the full benefit of devaluation in boosting exports. In many cases, our technical know-how has been provided by foreign private parties under various collaboration agreements. Very often, where world wide connections obtain, one of the contractual obligations on the Indian partner is not to export the product. Owing to the difficult foreign exchange situation, some foreigners relaxed this condition to the extent exports enabled Indian partners to obtain imported raw materials and spares. Now, since the Government has promised to do the needful in this matter, most probably this concession may be withdrawn. Thus the external parameter of our situation will prevent us from raising our exports. On the whole, therefore, owing to inelastic international demand for a majority of our exports, lack of exportable surplus, absence of export promotion schemes, or a change in the nature of incentives and a contractual obligation preventing exports, we shall not be in a position to take full advantage of devaluation. Add to this a booming home market and the will to export is further weakened. Now to the extent our exports do not increase substantially, there will be a dampening effect on the domestic price situation.

B. *Costly Imports*

What of imports? It is a straight forward proposition that our import bill will now go up by 57.5 per cent. Therefore, those industries consuming imports will have to raise their prices owing to a rise in their cost of production. Consequently, there is some truth in the official hypothesis that prices of commodities

[6] The official press release attributed "the rationale behind the decision to extend assistance has been that there is *no hope* in the foreseeable future of prices going down substantially as a result of increase in production." Vide *Economic Times*, 13 July, 1966, p. 1. Emphasis provided.

involving imported raw materials, components and spares will rise. This rise *will* not be equivalent to the extent of devaluation, as the incidence of revised import duties is greater than in the past. For instance, on a machine costing Rs. 100, there was a 45 per cent *ad valorem* duty, making its landed cost Rs. 145 in the pre-devaluation period. After devaluation, the same machine will cost Rs. 157.50, on which with an *ad valorem* rate of 27.5 per cent, the final price comes to Rs. 200. This is equally true of raw materials and components. Prices, therefore, of products consuming imported items will rise more than the extent of devaluation.

However, against this is to be posed the factor of excess capacity. Since 1962, most of our industries have been running at less than full capacity, the range being 46 to 50 per cent. Under the new import liberalization policy sufficient exchange will be provided to run such enterprises at full capacity for the next six months. If this happens, then certain economies of scale are likely to be realized, which may assist in lowering the cost of production. Whether this cost advantage will at all materialise and be passed on to consumers is problematical, as higher output will be available at a higher cost and as we are operating in a seller's market.

Inventory Accumulation

More than this consideration is the doubtful assumption that full capacity output will be forthcoming. For one thing, most of the import based industries have in the past exhausted their inventories. Hence at the first opportunity, the producers will attempt to replenish their stocks. In this decision, they will further be guided by the discontinuity of past policies. Very often, depending upon the type of foreign aid available, shifts in import policy have taken place. In the absence of continuity, manufacturers may prefer to build up an inventory. Further, as liberalization of imports is likely to affect the 59 priority industries only, the non-priority sector may siphon away some maintenance imports from the pipeline, of course at some premium. Moreover, looking to our labour laws and preferential treatment meted out to workers, many firms will be reluctant to accept the short-term responsibility of expanding the scale of operations. Rather

they will prefer to wait and find out, what the long-term policy of the Government is likely to be. It may also be that producers may prefer to intensively function with their present overheads, in which case the economies of scale would not be available, but diseconomies result.

C. *Liberal Imports*

More pertinent to our discussion is the dissection of the fundamental assumption on liberal imports. As a matter of fact, how liberal are liberal imports going to be in practice? An examination of Table 2 reveals that over the past years maintenance imports have taken the form of textile yarn, raw cotton, raw jute, raw wool and wool tops, dyes and colours, other chemicals, fuels and lubricants, iron and special steel, non-ferrous metals, transport and communication equipment and stores, and electrical goods. The sum of all these items comes to Rs. 455.13 crores, Rs. 441.5 crores, Rs. 441.8 crores, Rs. 442.7 crores and Rs. 412.5 crores in 1961-62, 1962-63, 1963-64, 1964-65 and 1965-66 respectively. This yields an annual average of Rs. 444.6 crores. Now with the use of these imports, we were in a position to employ less than 50 per cent of our capacity. If, therefore, the idea is to raise the utilisation to full capacity, then the value of maintenance imports should be doubled to about Rs. 889.2 crores.

As against this requirement, untied aid from friendly countries in 1966-67 is expected to be of $ 900 million. At the pre-devaluation exchange rate this comes to Rs. 428.4 crores, or a little less than what we were importing before. In physical terms, therefore, we cannot expect a larger inflow of goods and services, to cater to our full capacity requirement. The assumption of "liberal" imports hence breaks down under analysis. Instead, owing to devaluation, the rupee cost of liberal imports is likely to go up by 57.5 per cent. Such a financing even now is proving an obstacle to higher imports, as many licence holders find it difficult to find the needed money. In the absence of a follow up action on the import financing front, a liberal imports policy is not likely to succeed.

On balance, I am inclined to the view, that if all goes well, the industrial output level prevailing in 1964-65 may be restored, but at a rise in cost of production greater than devaluation.

Table 2

MAINTENANCE AND OTHER IMPORTS

(*Rs. in crores*)

Items	*1961-62*	*1962-63*	*1963-64*	*1964-65*	*1965-66*
Cereals	118.1	166.8	198.7	307.4	307.0
Fruits, meat, vegetables, milk, fish, spices, veg. oils, copra, rubber	42.5	45.6	43.4	43.7	40.8
Paper	15.0	15.7	13.1	15.7	20.1
Textile yarn	*11.6*	*12.5*	*11.1*	*13.9*	*4.6*
Raw Cotton	*62.9*	*55.9*	*46.3*	*50.9*	*46.0*
Raw Jute	*6.5*	*2.6*	*2.3*	*7.4*	*10.0*
Raw Wool and Wool tops	*9.2*	*11.9*	*13.2*	*8.0*	*5.4*
Fertilizers	15.2	15.1	13.2	15.2	36.5
Drugs and Medicines	8.4	6.6	5.1	5.4	8.9
Dyes and Colours	*11.4*	*10.3*	*8.7*	*9.2*	*6.6*
Other Chemicals	*35.6*	*41.3*	*34.9*	*36.2*	*49.0*
Fuels and lubricants	*87.9*	*82.7*	*97.7*	*86.2*	*68.0*
Iron and Steel	*90.0*	*77.1*	*70.7*	*73.8*	*98.4*
Non-Ferrous Metals	*46.2*	*53.9*	*49.8*	*57.2*	*68.2*
Machinery	240.6	276.7	382.2	416.6	489.0
a. Private	(139.2)	(141.8)	(161.4)	(138.3)	
b. Govt.	(101.4)	(134.9)	(220.8)	(278.3)	
Transport and Communication Equipment and Stores	*73.6*	*73.4*	*86.5*	*82.1*	*68.3*
Electrical Goods	*20.4*	*19.9*	*20.6*	*17.8*	*18.0*
Others	*110.9*	*123.3*	*133.2*	*149.3*	*49.2*
Total Imports	1006.0	1091.3	1230.7	1396.0	1394.0
Maintenance imports	*455.1*	*441.5*	*441.8*	*442.7*	*442.5*
Maintenance imports as per cent of total imports	*45.26*	*40.46*	*35.90*	*31.71*	*31.74*

NOTE: Figures in italics indicate maintenance imports.

Precisely for this reason, a psychological constraint on increasing output may prevail. Some businessmen have confided that they expect the landed cost of imported goods to be high. Therefore, they expect a rise in the cost of production and hence in the final prices. They are, however, not sure that in the present mood, the Government will give them permission to raise their prices to the fullest extent as witness the case of auto and steel producers. They are, therefore, reluctant to expand their scale of operations. Thus in terms of the above discussion, goods possessing imported content will be proportionately costlier than the cost of the imported element; hence prices will rise commensurately. Secondly, there is no firm expectation, in the immediate future, of output rising by the full extent of liberal raw materials inflow. The slower the rise in output, the greater is likely to be the impact on prices of goods possessing imported content. Lastly, the assumption that imports will be liberal appears to be incorrect. In terms of foreign aid earmarked for maintenance imports this year, the quantum value is a little less than what we were importing in the past. All that is likely to go up is the nominal value of imports. Even here, in the absence of follow up measures at liberalising import credit, genuine licence holders are finding it difficult to import to the full extent of their need.

II

INFLATIONARY FACTORS

This brings me to the discussion of the other factors responsible for the rise in prices. They may be lumped under:

a. Demand-pull, and

b. Cost-push.

A. *Excess Demand*

The second variable relates to the factor excess demand or demand pull, by which is generally understood to be a rise in money supply in excess of aggregate output. The applicability of this factor is revealed in Table 3.

It shows that in the First Plan, money supply fell short of the rise in real output by 4 per cent, yet prices as a whole declined by 17 per cent. This indicates that the traditional quantity theory relation of a one to one correspondence between prices and money supply was not maintained. The failure may be attributed to steep fluctuations in prices of primary commodities in the pre-and post-Korean War phases.

During the Second Plan, it appears, money supply grew faster than real income by 19 per cent, but the price level moved up by a faster rate of 35 per cent. In this case, the price behaviour observed is contrary to the one witnessed in the previous plan. The slow rise in output may be due to poor performance of the agricultural sector and the insufficient expansion in industrial output due to the foreign exchange crisis of 1958. On the other hand, in the Third Plan, a near co-relationship is visible; the excess of money supply being in consonance with the growth in prices.

Table 3

MONEY SUPPLY, REAL INCOME AND PRICES

(Rs. in crores)

Items	*1st Plan March 1951-56*	*IInd Plan March 1956-61*	*IIIrd Plan March 1961-66§*	*Total March 1951-66*
Increase in money supply*	14	41	57	112
Increase in real income†	18	22	23	63
Variation in prices¶	—17	35	32	50

NOTES: * Money supply is defined as currency with the public plus aggregate deposits, adjusted for P.L. 480 and 665 funds with banks.

† Real income is measured in 1948-49 prices.

¶ Prices refer to the behaviour of All-India Wholesale Price Index base 1952-53 = 100.

§ Data for the III Plan are tentative estimates.

SOURCE: Based on Table 1 contained in the study prepared by V. G. Pendharkar and M. Narasimham, *Recent Evolution of Monetary Policy in India,* Reserve Bank of India Bulletin, April 1966, p. 342.

It is thus seen that in three different Plan periods, we have had three different observations on the role of excess demand. This conflicting character of evidence may be reconciled with the fact that inexorable applicablity of the quantity theory apparatus lies in its secularity. Thus, if one were to examine the full period 1951 to 1966, then one finds that the growth in real output of 63 per cent was surpassed by the rise in money supply by 49 per cent, thus causing a rise in prices of about 50 per cent.

Deficit Finance

It may further be observed that the factor principally responsible for the growth in money supply is the created credit of the Government sector. This is shown in Table 4. As officially defined, deficit finance is understood to be "an increase in Government's debt (invariably assumed to be *ad hoc* Treasury Bills) held by the Reserve Bank of India and the ways and means advances by the Bank to Government, with appropriate adjustment for variations in Government's cash balances." No doubt, inflationary financing has a positive role in stimulating output provided certain conditions are present, such as excess capacity, small gestation period or low capital-output ratio and the ready availability of complementary resources. In the absence of such factors, created credit leads to a rise in prices.

If it is granted that demand-pull was the prime independent variable operating on the dependent variable prices in the secular period, then were there any factors causing a variation in behaviour during the cyclical period? According to one opinion the answer is in the negative, for it is quite feasible, that once their causal relationship becomes fully absorbed, money supply will adjust itself to the new situation following the Banking School. Yet the cyclical factors did operate, the variation being said to have been induced by the variable cost-push, which in its turn may be further sub-divided into income and taxation factors.

B. *Wages and Productivity*

Let us examine the income factor first which in non-technical

Table 4

OVERALL DEFICIT FINANCE 1951 TO 1966

(Rs. in crores)

Ended March	*Amount*	*Ended March*	*Amount*
1950-51	3.66	1958-59	221.94
1951-52	123.48	1959-60	169.58
1952-53	64.49	1960-61	+116.85
1953-54	80.95	1961-62	114.51
1954-55	142.40	1962-63	156.14
1955-56	159.87	1963-64	166.86
1956-57	184.75	1964-65	167.00
1957-58	458.58	1965-66-*a*	385.00

NOTE: a. Provisional.
SOURCE: *Reports on Currency and Finance.*

language in our situation refers to money wages rising faster than productivity. In this connection, an interesting study has been made by Sidney Weintraub.[7] He has employed the concepts of gross national market product, average productivity per worker and average earnings per worker. Gross national market product is defined by him as gross national product at market prices, less net income earned from abroad, less wages and salaries in Government administration, less one-third of net domestic product in agriculture. In turn, one-third of net domestic product in agriculture is assumed to represent that portion of agricultural produce that is not placed on the market for sale.

The data relevant to the above concepts is codified in Table 5. Column 2 there represents GNMP at current prices, while column 3 estimates the number of persons engaged in the GNMP sector. Dividing column 2 by that of 3, we obtain the average productivity per person engaged. In column 5, this is reduced to an index number, which reveals that productivity has been slowly rising from 100 in 1948-49 to 128.9 by 1962-63. These workers received in the form of total emoluments, an income as represented in column 6. Once again, if this is divided by the number of workers hired, we get annual average earnings per

[7] Sidney Weintraub, *Growth Without Inflation* (NCAER, New Delhi, 1965).

Table 5

MOVEMENT IN PRODUCTIVITY AND WAGES IN INDIA, 1948-49 TO 1962-63

Period	*GNMP at 1948-49 prices* (Rs. in crores)	*No. of persons engaged in GNMP sector* (In million)	*Average GNMP per person engaged*	*Index of average GNMP per person*	*Wages, salaries and earnings of self-employed classified as wage and salary earners in GNMP sector at current prices* (Rs. crores)	*Annual average earnings per person engaged*	*Index of average earnings per person engaged*
1948-49	7770.0	88.93	874	100.0	3106.2	349	100.0
1949-50	7949.1	90.26	881	100.8	3224.7	357	102.3
1950-51	7921.6	91.66	864	98.9	3377.0	368	105.4
1951-52	8251.2	93.11	886	101.4	3531.8	379	108.6
1952-53	8554.2	94.57	905	103.6	3499.2	370	106.0
1953-54	8986.5	96.03	936	107.1	3717.5	387	110.9
1954-55	9467.2	97.50	971	111.1	3468.2	356	102.0
1955-56	9713.3	98.97	981	112.2	3574.3	361	103.4
1956-57	10017.5	100.57	996	114.0	4060.0	404	115.8
1957-58	10182.7	101.79	1000	114.4	4147.0	407	116.6
1958-59	10698.1	104.02	1028	117.6	4506.8	433	124.1
1959-60	11017.5	105.73	1042	119.2	4652.7	440	126.1
1960-61	11766.4	107.32	1096	125.4	5102.8	475	136.1
1961-62	12160.3	108.91	1117	127.8	5394.3	495	141.8
1962-63	12458.8	110.51	1127	128.9	5623.6	509	145.8

SOURCE : S. Weintraub, *Growth Without Inflation*, pp. 59-60.

worker. Reduced to an index number in column 8, the data on per worker earings shows a movement which is faster than productivity. From this, it may be concluded, that money wages and salaries rose by nearly 45.8 per cent during the entire period of 1948-49 to 1962-63, whereas labour productivity rose in the same time by 28.9 per cent. To this extent, wage payments exceeded productivity by as much as 59 per cent. It may thus be said that wage-inflation was a potent factor in raising prices in the past.

C. *Taxes and Prices*

What was the contribution of taxes? This is difficult to say as no empirical work has been done. A monograph prepared by the Economic and Scientific Research Foundation attempted to provide an answer.[8] It sought to apply the Colin Clark test to Indian data. The original thesis of Colin Clark stated, "The data appear to give very considerable support to the hypothesis that once taxation has exceeded 25 per cent of the national income (20 per cent or less in certain countries), influential sections of the community become willing to support a depreciation of the value of money; while so long as taxation remains below this critical limit, the balance of forces favours a stable, or occasionally an increasing value of money". Colin Clark was so confident of his result that he generalised his finding as valid for "any non-totalitarian community in times of peace." Moreover, the relationship was assumed to be a lagged one. Declared Colin Clark, "The level of budgetary expenditure acts, by a more or less automatic procedure, as the fiscal determinant of the value of money, the cause taking perhaps two or three years to work its full effect." [9]

Given this hypothesis, its application is shown in Table 6. In that table, the data on deficit finance need a little explanation. It relates not to the measured quantum as defined by the Reserve Bank of India, but in addition the bonds held by monetary institutions. This inclusion is necessary as 72 per cent of

[8] *Taxation and Inflation in India, 1955-1965* (New Delhi, 1966).

[9] Colin Clark, *Public Finance and Changes in the Value of Money* (Economic Journal, December 1945), pp. 371-389. Quotations on p. 380 and p. 374.

the total public debt consists of bonds and only 28 per cent in the form of Treasury Bills. Further, deficit finance so defined is to be added to total tax revenue as generally it is accepted, that savings on national account should include both these elements. Assuming these to be valid, the ratio of total of taxed revenue plus deficit finance to money national income for India, during the period 1955-65, comes to 13.73 per cent for the base year, slowly rising to 18.27 per cent in the terminal year. While this ratio has been rising, prices as measured by the wholesale price index have also been edging upwards, thereby establishing a visual correlation between taxation and inflation.

Built-in Escalation

In this connection, the undesirable impact on cost of production of indirect taxes may be noted. These levies have gone up

Table 6

COLIN CLARK'S TEST FOR TAX CEILING

Year ended March	*Tax Collection of Centre, States and Local Authorities*	*Deficit Finance In India*	*Total of Taxes and Deficit Finance*	*Money National Income*	*Ratio of column 4 to column 5 In percent*	*All Commodities Wholesale Price Index 1952-53=100*
	Rs.	*Rs.*	*Rs.*	*Rs.*		
1	2	3	4	5	6	7
1955-56	857.34	512.65	1369.99	9980	13.73	92.5
1956-57	1019.45	600.37	1619.82	11310	14.32	105.3
1957-58	1198.61	780.45	1979.06	11390	17.37	108.4
1958-59	1235.87	752.06	1988.03	12660	15.78	112.9
1959-60	1346.77	653.41	2000.18	12950	15.44	117.1
1960-61	1535.46	546.98	2082.44	14160	14.71	124.9
1961-62	1738.66	635.35	2374.01	14630	16.23	125.1
1962-63	2063.04	647.39	2710.43	15400	17.60	127.9
1963-64	2547.72	838.69	3386.41	17200	19.69	135.3
1964-65	2774.25	825.21	3599.46	19700	18.27	152.7

SOURCE: *Taxation, Inflation and Economic Growth in India, 1955-65,* Table 3, p. 26.

substantially since the First Plan. For instance in 1951-52, excise duties collected by the Centre amounted to Rs. 87.78 crores. Budget estimates for 1966-67 place the same at Rs. 1,012 crores. On States account, the taxes on commodities and services amounted to Rs. 152.34 crores, whereas its yield in 1966-67 is expected to be Rs. 714.11 crores. As most of these taxes are at multiple points, they get added to the final cost at every stage of production, thus escalating the final price. Rough calculations, for example, have shown that the incidence of indirect taxes in terms of excise, sales, octroi and other duties would vary from 15 to 45 per cent of the cost of production of the finished product. Let me give a concrete instance. The selling price of a 8.25 × 20-12 ply tyre is Rs. 677. The sales tax payable on it comes to Rs. 67, the octroi duty in Bombay is Rs. 12, the excise duty Rs. 198, whereas the import duty and cess on raw materials and chemicals imported and used comes to another Rs. 85, thus making a tax total of Rs. 362, or 54 per cent of the total price. It may be mentioned that this percentage excludes direct imposts and taxes paid by the raw material manufacturers. If these were included, the percentage would be still higher.

D. *Ambitious Planning*

Now what is the expectation regarding the future movement of deficit finance, wages and taxation? Insofar as deficit finance is concerned, there is no sign that it will be given up for good in the future inspite of official protestations to the contrary. As a matter of fact, all portents are to the contrary. It is claimed that as a result of devaluation, the financial outlay on the Fourth Plan will rise. At first it was expected to grow to Rs. 28,500 crores, but currently, it is placed at Rs. 23,750 crores. Though the overall size of the Plan has been raised, we do not know how the resource structure is likely to behave. Frankly, the pattern of resources has never been made known to the public in detail. For instance, in the Plan Outline released in September 1966, unlike as in other years, bare statistical tables are inserted with a ten page introduction.[10]

[10] Planning Commission, *Fourth Five Year Plan, Draft Outline, Programme and Targets* (New Delhi, 1966).

All it says is that the financing of public sector outlay will be done by:

	Source	Amount
1.	Balance from current revenues at current tax rates plus railway's contribution	3,270
2.	Surplus of public sector enterprises	1,085
3.	Borrowings including small savings and unfunded debt	3,065
4.	Miscellaneous receipts	815
5	Foreign Assistance	4,700
6.	Total available	12,935
	Gap to be filled	
7.	Mobilization of additional resources	2,730
8.	Economies in non-plan expenditure	325
9.	Total public expenditure	16,000

A unique feature of the resource pattern shown in Table 10 is, that a deficit of Rs. 470 crores on the item balance from current revenues at pre-Plan rates of taxation in the III Plan, is converted nues at pre-Plan rates of taxation in the III Plan is converted into a surplus of Rs. 3,010 crores in the IV Plan! Likewise, borrowings on all accounts of Rs. 1,940 crores in the III Plan shoots up to Rs. 3,065 crores in the IV Plan. Similarly, foreign assistance goes up from Rs. 2,455 crores to Rs. 4,700 crores between the two plans being examined. Moreover, mobilization of additional resources, which has invariably meant raising of taxes, amounts to Rs. 2,730 crores. All these are doubtful entities.

In any case, should this exercise be inferred as the overt intention of Government not to cut down on its expenditure, it will serve as a psychological booster to an expectation of rising prices. A sympathetic rise in prices will cause a general upward movement. This phenomenon will also operate due to devaluation. For instance, with devaluation, when prices of imported items are likely to go up, they will serve as a protection wall. To that extent, prices of domestic goods which are normally substitutes or in short supply will rise *pari passu*. A classical case is provided by raw cotton. The price of American cotton following devaluation went up to Rs. 2,400 per candy. Immediately,

equivalent Indian varieties also rose in sympathy to round Rs. 2,200 to Rs. 2,400. In the previous year, the Indian growths were being quoted at rates varying from Rs. 1,700 to Rs. 1,800.

Should inflation be generalized, and borrowings and large taxation imply it, then it will be difficult to observe a general incomes policy of restraint. Labour, irrespective of movements in productivity, will clamour for a wage rise. This, wherever cost of living index-tied will automatically occur; in other cases, the same end may be realized with greater or lesser conflict. As such, prices after devaluation will continue to rise, their extent varying with the degree of taxation and deficit finance undertaken from time to time.

Price Stabilization Measures

In this gloomy price forecast, where does the avowed policy of price stabilization stand? As a short-term panacea, the Centre has announced the appointment of a Commissioner of Civil Supplies, opened a control room at New Delhi to establish liaison with States, to collect daily data of ruling prices, and estimate the supply position of important commodities. It deputed Cabinet Ministers to different parts of the country, to get a direct undertaking from the business community not to raise the prices of their products. A scheme is being prepared for opening 10,000 department and fair-price shops. The Department of Co-operation has even submitted a tentative programme of distribution through cooperatives, but nothing has been heard about it since the last three months.

Moreover, a three-tier strategy has been worked out to contain the rise in prices. One, the Essential Commodities Act has been enlarged not only to cover more commodities, but has also been amended to provide for stringent punishments. Two, manufacturers are being asked to make arrangements for the sale of essential goods at fair prices through their own distributors. If needs be, a forced levy may be made at the production end itself, for subsequent distribution through chain stores. Three, wholesalers are being contacted to bring pressure on retailers to sell at listed prices prominently displayed in their shops. AIR even broadcasted daily price quotations of principal commodities.

Upward Movement

As usual, these proclamations remained pious platitudes. Within days AIR Bombay stopped broadcasting prices of various commodities, as its quotations were at great variance with those prevailing in free markets. The decision to open department stores has not moved beyond the requisitioning of the Pant Super Market in New Delhi—that too not without controversy. Manufacturers have dutifully advertised in the papers their prices remain unchanged, but in the market, these very products are not available except at a higher price. The result has been that in almost all the States post-devaluation prices have showed an upward trend. Vegetables, for instance, are not available except at Rs. 2 per kilo; instead of Rs. 1.25 to Rs.1.50 a kilo; price of rice has risen by 15 per cent; that of edible oils has increased by 10 to 20 per cent; price of meat and fish has increased by 25 per cent; paper and its products have gone up by 10 per cent; toilet articles are costlier by 5 to 25 per cent; while blades, matches and some popular brand of cigarettes have increased by 10 per cent.

Unfortunately, in releasing this upward momentum, a bad example was set by Government itself. The Government of Maharashtra gave a lead in ten days after devaluation by raising the price of rice and wheat. The Centre played its part by increasing the price of high grade lubricants and greases by 10 per cent. It also raised by 50 per cent, the incidence of Central Sales Tax to 3 per cent. In U. P., the Sales Tax on various commodities was raised. A further impetus was given by reverting to the old policy of equally distributing a scarce product, rather than emphasising the ways and means of increasing its production. If prices are to be held stable output must expand. How it should be done would lead me to an entirely new discussion. Suffice to say, that owing to devaluation, prices will rise, the magnitude of the increase being a dependent of the degree of deficit finance, level of taxation, wage increases and costly import inputs. This rise will certainly be more than the cost of import content. The price rise will further be widespread and not just restricted to imported goods. The fear of an increase in price greater than officially expected, further arises from considerations of a less modern economy. Where primitive means of pro-

duction are employed for a large section of the productive apparatus, the chance to absorb higher cost of production by higher productivity is low. With devaluation, the higher import costs have put a discount on this trend. Hence, a sharp rise in prices is likely to result owing to devaluation.

Paper VII

DEVALUATION AND THE FOURTH PLAN

B. RANGASWAMY

WITH THE DEVALUATION of the rupee, all the labour of the Planning Commission to formulate the Fourth Five-Year Plan has almost been a waste. The detailed calculations made by the Yojana Bhavan to determine the aggregate Plan outlay have gone awry, since devaluation has upset the entire cost-price structure of the economy, present and prospective. Even before devaluation, the calculations had been distorted by the persistent increase in prices and the mounting burden of defence expenditure, due to the war with Pakistan (in August-September 1965) and the continued hostile posture of China. The Perspective Planning Division of the Planning Commission, it will be recalled, had originally envisaged an outlay of Rs. 22,000 crores in terms of 1960-61 prices. A much lower but more realistic size, involving an aggregate outlay of no more than Rs. 18,000 crores, was canvassed early in May 1964 by some sections of the Planning Commission and the Union Government. As a compromise, however, the figure of Rs. 20,000 crores in terms of 1960-61 prices was then adopted by the Commission as a 'working basis' for the formulation of the Fourth Plan. The Commission kept this compromise framework more or less in tact in its draft memorandum which recommended a minimum outlay of

Rs. 21,500 crores and, resources permitting, a maximum outlay of Rs. 22,500 crores—both figures being in terms of 1963-64 prices which, as reflected in the wholesale price index, were 10 per cent higher than those of 1960-61. As the Union Cabinet and the National Development Council both endorsed the Planning Commission's memorandum, it had been supposed that there was an air of finality about the size, strategy and objectives of the Fourth Plan.

But the war with Pakistan and the further marked rise in prices upset the calculations of planners again. Towards the end of May this year, that is, just a few days prior to the announcement of devaluation, the Planning Commission was reported to have suggested, despite all the well-reasoned comments by experts (including many who have no axe to grind), an upward revision in the Fourth Plan outlay from Rs. 21,500 crores to Rs. 22,300 crores, instead of scaling it down. The upward revision was attributed to two factors, namely, rise in the costs of certain industrial projects and the need for stepping up physical programmes in certain sectors of development. I am mentioning all this just to emphasize how the planners' discussions have had an air of unreality and excessive zeal for gigantism.

Within a week after the report of the Planning Commission suggesting an outlay of Rs. 22,300 crores appeared in the Press, the Government of India announced the devaluation of the rupee. Devaluation has inflated both the rupee content and the foreign exchange content of all plan programmes, in the public as well as the private sectors. It is estimated that, as a result of devaluation, the figure of Rs. 22,300 crores mentioned by the Planning Commission at the end of May 1966 will be substantially higher at not less than Rs. 24,000 crores. The foreign exchange gap of Rs. 4,000 crores assumed before is expected to swell to a total of Rs. 6,300 crores, because of the 57.5 per cent appreciation in the value of foreign currencies in relation to the rupee.

Two important questions arise:

One, is the outlay of Rs. 24,000 crores feasible?
Two, what will be the impact of such a heavy outlay on the economy of the country?

Let me examine these questions.

The Planning Commission may be tempted to fix the outlay at a high level on certain assumptions. One of the assumptions is that bigger surpluses will be squeezed out of public sector undertakings. Another is that substantial revenues would be raised through additional taxation; the State Governments are expected to mobilize resources on a much larger scale than had been the case so far. Two other assumptions are: (1) There will be no need for large-scale deficit financing; and (2) adequate external assistance would somehow be forthcoming. I do not think that any one of these assumptions will prove correct and, if for argument's sake, even one assumption were to prove correct, it would be a miracle indeed.

It would be sheer moonshine to think of raising resources of the order of Rs. 24,000 crores—or Rs. 4,800 crores a year on an average—over a short span of five years. I wonder whether the Planning Commission can take for granted the certainty of expected or unexpected surpluses emerging from better agricultural performance and the operations of public sector enterprises. The surpluses secured so far are well below those estimated by the planners. I also wonder whether the State Governments will be able to raise additional resources to the tune of Rs. 3,000 crores to Rs. 3,600 crores. The experience in this regard during the fifteen years of planning has been very disappointing. The inevitable result will be increasing reliance on deficit financing and additional taxation, both of which are fraught with dangerous consequences to the economy, inasmuch as they aggravate inflationary trends. Let me recall here the experience of the Second and Third Plans.

The Second Plan had taken credit for a deficit financing of Rs. 1,200 crores and an additional taxation of Rs. 450 crores. But actually, while the deficit financing was lower at Rs. 950 crores, additional taxation came to as much as Rs. 1050 crores, since the calculations about the other elements in the resources budget went awry. Similar was the position in respect of the Third Plan. Thus, as against the estimate of Rs. 550 crores for deficit financing, the actual was Rs. 1,400 crores, the deficit financing resorted to during the last year (1965-66) of the Plan alone being no less than Rs. 400 crores. This order of deficit financing was incurred, notwithstading the heavy taxation (both direct and indirect) imposed by both the Centre and the States. Such

additional taxation, at Rs. 2,850 crores, brought in Rs. 1,150 crores more than the amount (Rs. 1,710 crores) budgeted for the Third Plan period as a whole. A large part of these additional resources has been swallowed up by non-Plan and non-development expenditures.

Large-scale deficit financing is clearly reflected in the significant expansion of over Rs. 1,710 crores in money supply (up to the end of June 1966), the rise in the past one year itself being Rs. 430 crores. Since the rise in Money supply has not been accompanied by a proportionate increase in the availability of goods and services and since there has also been cost inflation in industry caused by increased tax burdens, heavier wage bill, markedly higher raw material prices, increased prices of fuel, stores, chemicals and other accessories, and enhanced freight charges, there has been a distinctly upward pressure on prices. Since the beginning of the Third Plan, prices have risen by as much as 50 per cent, the rise over the past one year alone has been over 17 per cent. Judged against this background, it is clear that an outlay of the order of Rs. 26,000 crores during the Fourth Plan will aggravate the inflationary potential in the economy, thereby subjecting the masses to still greater hardship.

Some may say that there is nothing wrong in fixing the outlay at a high level, for if for some reason or other, sufficient funds cannot be raised, a few projects, according to them, can be spilled over to the next Plan. This, however, is not the correct strategy of planning, not to speak of the disappointment and frustration among the public at large caused by shortfalls in Plan targets. I may as well ask: Why plan at all?

While it is extremely doubtful whether the Central and State Governments will be able to raise funds to finance their share (Rs. 17,500 crores) of the aggregate outlay of Rs. 26,000 crores, it is perhaps hazardous to think optimistically about the private sector's capacity to muster the resources to meet an outlay of Rs. 8,500 crores.

I must, in this connection, draw attention to five causes of stress in the Plan.

1. The absence of sizeable foreign exchange reserves is the first of these. The total of such reserves, as of today, stands at no more than Rs. 211 crores, even after taking

into account the I.M.F. standby credit of Rs. 90 crores received in March 1966 and the adjustment in reserves following devaluation.

2. The second is that the pattern of external assistance—the tied nature of credits and the delays involved at either the Indian or the external end—can cause short-term problems, irrespective of the overall adequacy of the amount of aid offered.
3. The third source of stress pertains to possible failures in achieving superior export performance. The aggregate revised Fourth Plan export target of Rs. 9,000 crores may not be fulfilled because of the difficulties in holding prices within manageable limits and the reluctance of importing countries, especially the developing ones, to buy on a much larger scale than they do at present.
4. Fourthly, there is the old problem of miscalculation arising from inadequate preparation of blue prints, lack of provision for rising machinery prices abroad, the burden that can be caused by fortuitous factors, and the failure in phasing which may cause short-term spurts in the demand for unplanned imports.
5. The fifth cause of stress is the one arising from devaluation, viz., the increase in the burden of foreign debt servicing (payment of interest and repayment of capital). In terms of the current rate, external debt-servicing obligations during the Fourth Plan period are estimated to go up from Rs. 1,350 crores to about Rs. 2,130 crores. A major problem posed by the devaluation of the rupee is the enormous increase in the burden of foreign loans incurred by the private sector. Apart from the question of finding the requisite resources for meeting the additional burden, the enhanced debt liability is likely to alter the debt-equity ratio in several units. It may also disturb the investment-output relationships in many others.

Viewed against this background and considering that the prospects for foreign aid are not so bright, it is not at all economic wisdom to pitch the Fourth Plan outlay so high at Rs. 26,000 crores, especially in the context of the everrising prices, administrative inefficiency, technical and technological

deficiency, and organizational inadequacy, besides several other physical limitations. The Plan outlay ought to be fixed, not in relation to the goals related to the needs of the nation, but on the basis of resources—both financial and physical—that can be mobilized without subjecting the economy to further serious stresses and strains. This, at any rate, is the lesson which the experience of the Third Plan has taught us. The planners cannot abdicate either sense or responsibility in search of political favours. Better counsel, I hope, would prevail upon them and they would cut the coat (Plan outlay) according to the cloth (resources) available or in sight.

On the basis of a cautious estimate of foreign exchange availability and a conservative estimate of possible internal resources, I am inclined to feel that the only realistic and practicable size for the Fourth Plan would seem to be Rs. 20,000 crores at current prices. I would like to emphasize the words 'at current prices'. This can be expanded later to any size ranging from Rs. 20,001 crores to Rs. 25,000 crores, depending on the availability of both external and internal resources. The whole Plan should be divided broadly into two parts. The first part should cover the early period of the Plan when attention should be concentrated on first-priority projects and programmes. The second part should cover the latter part of the Plan when second-priority projects and programmes could be taken on hand in the light of achievements during the first two or three years of the Plan. In the first part, special stress must be laid on the following quick-yielding projects, alongside of a bold programme of population control:

1. Minor irrigation covering tanks and wells.
2. Intensive cultivation in irrigated areas.
3. Consumer industries and other industries which can yield quick results and augment the country's export potential.
4. Road transport.
5. Labour-intensive works programmes.
6. Further utilization of (*a*) all existing capacities in industries, (*b*) irrigation potentials created under major and medium projects, and (*c*) other facilities developed by the Plans.

It is only these projects that will release additional resources for development and more plentiful supplies of wage-goods that can neutralize inflationary pressures. Moreover, the successful implementation of these projects will facilitate the implementation of the second-priority projects and programmes.

I would like to spell out more clearly what, in my opinion based on the modest Annual Plan for 1966-67, is the correct strategy for the Fourth Plan.

A high priority must be accorded to agriculture, irrigation, soil conservation, flood control and family planning. In the field of agriculture, special accent should be put on schemes of quick-yielding nature, designed to raise production in the shortest possible time. This should be particularly so in respect of minor irrigation and soil conservation schemes. The problem that merits due attention is the insufficiency of inputs (such as manures, chemical fertilizers, irrigation, pesticides and new crop varieties of proved genetic capabilities) that inhibits agricultural growth.

As for industry, I stress the following:

1. Fuller utilization of existing capacities in industries, rather than fresh investment for establishing additional capacities in them:
2. Expeditious completion of projects which are well under way and on which substantial investments have already been made; and
3. Adoption of highly selective approach in so far as new projects are concerned, attention being concentrated on projects which help defence effort and further the drive for import substitution, and expansion of exports through diversified and increased industrial production or provide inputs for agriculture.

I urge that some of the Government development programmes like Community Development or capital-intensive projects, with chronically low yields and excessive gestation periods, should be kept in cold-storage, that expenditure on extensive construction as part of development projects and on prestigious buildings be curtailed, and that all projects based on political, social and/or ideological considerations be ruthlessly eliminated.

In other words, in the changed context of things arising from devaluation, the Fourth Plan will be a success only if it is a modest one (from the point of view of outlay), with stress on

(*a*) consolidation and completion of continuing scheme;
(*b*) complementary development of agriculture and industry;
(*c*) fuller utilization of existing capacities and facilities in all sectors;
(*d*) quick-yielding agricultural and irrigation schemes; and
(*e*) avoidance of new schemes and projects as much as possible.

I now come to the private sector in the Fourth Plan. In view of the devaluation of the rupee, the part that this sector will have to play is much larger than what has been assigned to it. It is true that devaluation, by discouraging imports and encouraging exports, provides a strong inducement to both import-substitution and to greater production in export industries. But devaluation has also brought to the fore the problem of rupee resources. As Mr Asoka Mehta has himself acknowledged, the problem of rupee finance for the private sector is a real one. Apart from devaluation, the relevant factors here are a domestic price increase of nearly 30 per cent in the last two years and a diminution in savings. Many industries are being squeezed so much by persistent cost inflation, on the one side, and a stiff tax burden, on the other, that the margin of profit is too low to pay a decent return to investors (this is a very important point in the context of the vital need to ensure an adequate flow of investment into industries) and to leave sufficient amounts for expansion and development. If, therefore, the private sector is to play the role expected of it, it is of the utmost importance that the fiscal, monetary and economic policies are reoriented on a rational basis. I suggest the following course of action:

1. There is, first of all, the urgency of a cut in corporate taxes with a view to (*a*) providing additional capital needed for faster growth, (*b*) encouraging the cost-reducing modernization of plant and equipment needed to make Indian exports more competitive in world markets,

and (*c*) permitting lower product prices in many industries where present corporate taxes are, at least in part, passed on to consumers.

2. There is then the need for moderating increases in money wages while stimulating efforts to raise productivity.
3. The present credit policy should be modified to enable the industry and trade to secure adequate finance at a reasonable cost. The problem of working capital requirements of industries merits particular attention. Care, however, should be taken to restrain inventory build-up.
4. The process of decontrol should be carried further. All licensing controls on industries which do not require any foreign exchange for expansion or maintenance must be done away with. Licensing procedures must be simplified further and there must be a periodical review of licences granted, in order to ensure the removal of any hurdle standing in the way of their utilization. It is only a proper co-ordination of licensing, fiscal and pricing policies that will accelerate the rate of industrial growth that has remained sluggish for quite some time now.

I wish to conclude this paper with a fervent appeal to the planners, the authorities, industry, trade, labour and the public in general. The planners and the authorities should eschew extravagant and unrealistic planning; the industries should endeavour their best to augment production as rapidly as possible and to decrease or control their costs; the traders should enforce upon themselves a code of fair trading practices; labour should realize its responsibilities fully and lend unstinted support and co-operation in the task of achieving maximum production; and the public in general should avoid excessive consumption, so that the exportable surpluses of goods will be larger. In fine, the Fourth Five-Year Plan poses a challenge before the whole nation. It is on how this challenge is met that will depend the future of the country.

Paper VIII

DEVALUATION AND BALANCE OF PAYMENTS

D. K. SHUKLA

THE INDIAN RUPEE has been substantially devalued. Only the future course of economic events would ultimately decide the wisdom or otherwise of our decision to devalue. It is possible to say that much will depend upon other economic decisions which we shall take to revive economic growth.

If devaluation is not found beneficial, it is always possible to nullify the impact of devaluation on specific spheres of economic activity by introducing an appropriate system of taxes and subsidies. As we shall see, only by introducing such a system we shall be able to develop a system of specific export and import prices which, under given internal and international economic situation, yields us the greatest benefits in the form of yielding the highest amount of foreign money and making it possible to use the foreign money to secure only the most essential imports. In fact, during the period of the Third Plan, we have tried to develop such a system by using a system of export subsidies and import taxes, on a substantially wide scale. However, when we view devaluation as a blanket measure to replace by and large, the system of specific actions the question that naturally arises is: whether by devaluation we shall be able to solve the

problem of our balance of payments disequilibrium! Will devaluation yield us the maximum amount of foreign money through the sale of our exports? Will it, by itself make it possible to use our export earnings most economically? These questions are very important because devaluation is supposed to relieve the pressure on the balance of poyments by encouraging foreign expenditure on the goods and services of a country and by discouraging expenditure on foreign goods and services by its citizens. It is supposed to produce these effects by bringing into alignment the internal and international prices. It is undertaken to cure the imbalance between the internal and international prices which has arisen because of a higher degree of inflation within the country as opposed to the other countries with which it has important trade relations.

Some Vital Questions

The question that naturally arises is: Did India experience an imbalance of internal and international prices? If it did, did the relative inflation in India produce a harmful influence on our export earnings? Did it restrict our quantum of exports so as to cause a stagnation in our export earnings? Did it encourage expenditure on foreign goods and services? Was the system of specific controls not adequately functioning in this situation of relative inflation? And was this condition of relative inflation a temporary situation arising out of distinctly specific non-repetitive causes or was it the result of causes which are likely to be of long-term influence? These are very vital questions to answer. The rightness or otherwise of devaluation in our present condition can be analysed only when we are in a position to have at least broad answers to these questions.

If we find that the relative inflation in India after 1960 did not produce any harmful effect on our export earnings, but on the contrary, the system of specific taxes and subsidies did work substantially well, the conclusion becomes inevitable that in our situation what is needed is not any blanket changes in prices to resolve the balance of payments disequilibrium but some system of specific controls. However, if we find that the system of specific controls also does not yield us the growth in export earnings that is so much necessary for our future deve-

lopment, a further question which is essential to consider is: how far is our balance of payments disequilibrium due to price-imbalance and how far is it due to the saving-investment imbalance in our economy? For it is my contention that the whole price approach to our balance of payment's is wrongly conceived, we shall be able to understand and control our balance of payments disquilibrium, adequately only when we consider it from the point of view of the saving-investment approach.

Course of Prices

A *prima facie* case for devaluation can be made on the grounds that a structural imbalance has arisen between the internal and the international cost-price structure due to a higher degree of inflation within our country than the outside world, as represented by a few selected countries having substantial trade-links with our own. When we want to have a comparative picture of the degree of inflation which has arisen in the various countries, the base period which we choose for such a comparison is important. For the average annual rate of rise in prices in different countries can be different when worked out with different base periods. We shall take 1950 as the base year to start with, primarily because we had once devalued the rupee along with the pound sterling in 1949 and also because our planning efforts began after that year. Table 1 below shows the average annual change in prices in some selected countries during the period 1950 to 1960.

Table 1
CHANGES IN WHOLESALE PRICES BETWEEN 1950 AND 1960

Country	*Annual average percentage change*
Australia	6.23
Canada	0.83
France	6.70
West Germany	2.60
Japan	4.40
UK	3.30
USA	1.60
India	1.24

It is evident from the above data that compared with most of the countries in the world India experienced a smaller degree of price-rise during the decade of 1950-1960. Thus, if we take this period in general the relative price-changes in India and abroad were not such as to hinder Indian exports.

However, if we examine the price changes in India and abroad during the period 1958 to 1964 (given in Table 2) we find that India did experience a higher degree of price-rise compared with most of the countries in the world. If this is so, the price-imbalance does establish a case for inducing some sort of relative price changes in India compared with the outside world. However, the fact that Indian prices have risen faster than world prices during the Third Plan period does not by itself prove the necessity of devaluation. For in the first place, though relative price-rise has taken place, it should be proved that it is of a nature which hinders our export earnings in general. If the price-rise does not hinder the growth of our export earnings all round, but it affects only specific type of commodities, what is needed is only a specific system of export subsidization and not a blanket measure like devaluation or deflation. Secondly, even if it is proved that the relative price-rise does harm our export earnings, it does not prove the necessity of devaluation as such. For, in a situation of inflationary pressures and the absence of unused plant capacity in general, deflationary measures are likely to prove to be a better alternative to devaluation.

Table 2

CHANGES IN WHOLESALE PRICES BETWEEN 1958 AND 1964

Country	*Annual average percentage change*
Australia	1.0
Canada	1.6
France	3.8
Germany	1.6
Japan	0.6
UK	2.4
USA	Nil
India	6.8

However, in a complex economic situation such as ours where there are inflationary pressures, and still the need is there to stimulate economy for higher rates of growth, on such blanket measure like deflation or devaluation is likely to prove helpful. Such a situation where there is no general unused capacity in the system and, therefore, where the supply of exportable commodities in general is not very elastic, and where the system cannot afford a general dose of deflation, the only remedy of the situation lies in: first, taking measures to increase internal saving and export surpluses, and secondly, selling these export surpluses at maximum possible prices in the foreign markets through a system of specific subsidies and taxes so as to maximize our foreign exchange yields from a given exportable surplus. The argument of not resorting to devaluation just to correct a relative price-rise, gains all the more strength if we take into account the fact that the price-rise in our country which took place after 1960 can be attributed to two specific causes which are likely to be of a temporary nature only. The price-rise in India which took place after 1960 was due to: (*i*) the stagnation in agricultural production during the Third Plan period, and (*ii*) the increase in government expenditure particularly on defence due to the aggression on our territory by China and Pakistan during this period. This means that, if we can achieve adequate increase in agricultural production, if we are able to raise our saving-income ratio adequately to meet both expenditure on defence and development and if we can restrict unproductive expenditure in the system, the price-rise which has taken place can be limited and even reversed. In view of these specific causes of our price-rise which with proper efforts on our part are likely to turn out to be of a temporary nature, there is no need to take any blanket measure such as a deflation or devaluation. However, all the above arguments were based on the fact that we suffered in terms of export earnings due to the relative price-rise. The question is: How far have we suffered in terms of export earnings as a result of the relative price-rise in our economy?

Export Earnings

An important question which is relevant to decide whether

devaluation can help us to earn larger amounts of export earnings or not can be broadly answered by studying the relationship between internal price changes and our export earnings in the past. It is true that during the course of a long period apart from internal prices many other factors also change and have their impact on export earnings. But it is still generally interesting to know what type of relationship prevailed in the past between our export earnings and internal price changes.

During the course of the First Five-Year Plan, the internal prices over the period declined by about 18 per cent, thus giving the annual average percentage price change of the order of —3.5 per cent. As opposed to this type of deflationary trend during the First Plan, prices increased by about 30 per cent during the Second Plan, thus giving the annual percentage change in prices of the order of 6 per cent. During the Third Plan period as well, prices rose by about 35 per cent, giving the average percentage change in prices of the order of about 7 per cent. Table 3 below gives the annual percentage change in the internal prices and the annual percentage change in export earnings during the three Plans.

Table 3 clearly indicates that there does not seem to be any inverse relation between the internal price-charges and export earnings. In fact, for the First Plan period when internal prices were falling the rate of growth of our export earnings was the least. During the Second Plan in spite of internal price-rise, we achieved a slightly higher growth rate of our export earnings; while during the Third Plan in spite of a substantial price-rise we have achieved a substantial high rate of growth in our export earnings. However, our export performance may not be

Table 3

PLANS AND AVERAGE PER CENT CHANGE

Plan	*Average annual change in prices*	*Average annual change in export earnings*
1st Plan	—3.5	+0.4
2nd Plan	+6.0	+0.7
3rd Plan	+7.0	+5.6

influenced so much by the absolute changes in our prices alone but may be influenced by changes in relative prices, that is to say, price changes in our country in relation to the outside world. If we take the relative price changes in India and abroad as shown in Tables 1 and 2 we find that during the decade of 1950 to 1960 the Indian prices increased very slowly compared with the foreign prices. During this decade which roughly corresponds to the period of the first two Plans the export earnings rose only at the annual rate of about 0.5 per cent. While in the next five-year period from 1960-65 Indian prices rose comparatively at a much faster rate than the foreign prices, and still the annual rate of growth of our export earnings during this period was substantially high, being 5.6 per cent. These figures do indicate that the relative price-rise that we experienced did not hinder the growth of our export earnings; in fact, it seems to have helped it. This fact is seen more clearly when we study the rate of growth of our export earnings in relation to the rate of growth in the quantum (volume) of exports. During the First Plan period the quantum of exports moved up at the annual average percentage rate of about 4 per cent, while export earnings grew only at the rate of 0.1 per cent, during the Second Plan period the rate of growth of the volume of exports seem to be almost zero and the rate of growth in the earnings was about 0.7 per cent. While during the Third Plan period the available data up to 1964-65 show that the volume of export has increased at the annual percentage rate of about 5 per cent, while the export earnings have increased at the slightly higher rate of 5.6 per cent. All these facts indicate: (*i*) Growth in the quantity of exports does not depend on the relative change in general prices as such; but on the contrary, it seems to be dependent upon the availability of specific incentives through a system of specific subsidies. For only during the Third Plan period we evolved a system of specific subsidization and only during that period in spite of a relative price-rise in India, we were able to increase our quantum of exports at a substantially high rate; (*ii*) During the period of the internal price-rise (and relative price-rise also) the export earnings have increased at a slightly faster rate than the quantum of exports. This indicates that within the particular price range in which our price-rise took place the elasticity of the demand for our exports in gene-

ral tend to be less than unity, so that the price-rise induced larger amount of foreign expenditure on our goods. It is true that when we have devalued the rupee there is the possibility of substitution of our exports for exports from some other countries. For example, our tea becoming cheaper may drive away the demand from Ceylon tea or our jute goods may compete away demand from Pakistani jute goods. However, none of these countries can be expected to sit silent and suffer the loss of exports; and hence they are bound to take preventive action of some sort or other. When this happens the price elasticity of the demand for exports cannot remain at the high level. Thus in assuming that after devaluation price elasticity of our demand, for exports in general will be less than unity we, in fact, assume that for our traditional exports which provide the major share of export earnings, there will be little scope of gaining bigger world market through substitution. If the price elasticity of our exports in general is less than unity within the relevant price range, the devaluation is likely to lead to a fall in our export earnings as measured in terms of foreign currency. Also the 36.5 per cent devaluation of the rupee would mean that to earn the same amount of foreign money, we will have to export 36.5 per cent more goods, provided internal prices do not rise and nullify to that extent the price effect of devaluation. Thus, if we do not allow the internal prices to rise, which we will try our best to do, and if we do not adopt the system of specific taxes on our exports, we will lose in real terms due to the terms of trade disadvantage.

Terms of Trade

Devaluation leads to an unfavourable change in the terms of trade. Assuming no change in domestic prices at home and abroad, a 36.5 per cent devaluation would mean that now we will have to give 36.5 per cent more of exports to buy the same quantity of imports. Thus assuming the period before devaluation as the base period, the devaluation would mean that 1 unit of import now would require 1.365 units of exports instead of 1. If our imports constitute about 6 per cent of our national income, about 40 per cent more of national output will be necessary to purchase them now. Even when a part of the imports

are financed by foreign loans, the matter does not change substantially, for ultimately the imports will have to be paid for by exports. Thus devaluation of 36.5 per cent if not nullified through taxes or internal price-rise would cause a transfer of about 2.4 per cent of our national output to foreigners as a subsidy to them. Thus devaluation which involves such transfers of output from the country resorting to it to the foreigners will be lightly undertaken only by a capitalist economy suffering from unused plant capacity and insufficient home demand for its output. A planned economy suffering from general scarcity of goods at home cannot undertake such a measure, for either the measure would lead to corresponding price-rise within the country, or to the extent that it is not allowed to do so, it will accentuate the internal shortages of commodities.

If we accept the fact that the availability of foreign aid largely depended on the devaluation of the rupee and we assume that foreign aid constitute about 4 per cent of national output, we must note that unless the terms of trade effect of devaluation is nullified through internal price-rise and/or a system of export taxes, a more than half the gain of foreign aid will be neutralized through the terms of trade disadvantage. Hence, in our case now if we cannot think of revaluation, the only alternative will be to follow an appropriate policy to nullify the evil impact of devaluation.

Appropriate Measures

Devaluation will not yield larger amount of foreign earnings through the exports of commodities, the elasticity of which is less than unity within the relevant price-range. In the case of such exportable commodities it will be necessary to nullify the price-fall due to devaluation by a system of specific export duties. Thus the blanket measure of devaluation will not make it possible to do away with the specific system of taxes and subsidies which we were operating before it was undertaken. Similarly in the case of imports, we will have to either lower import duties or give positive subsidies in the case of commodities whose internal prices we do not want to raise. Thus in the case of imports also, it will be necessary to operate a system of subsidies and taxes. Only in the case of foreign money to be brought into

India, we will now be able to remove the system of special incentives, provided we find that the 36.5 per cent devaluation gives sufficient incentives to those who want to bring their foreign money into India so that they will not be tempted to use non-official channels. Against this simplification of the system, we will have to devise ways to raise larger amount of rupee to finance our repayment and interest of foreign debts. Also earnings of foreign companies working in India are likely to become less attractive to the foreigners and this may adversely affect the flow of private foreign capital or its reinvestment in India. In this field also, it may be necessary to rework our system of incentives for the foreign investors.

Export Taxes

However, the most important policy measures which we will have to undertake will pertain to the curbing of inflationary pressures which are likely to arise in our system. Inflationary impact of devaluation would arise because of the operation of two forces. In the first place, if we do not completely nullify the terms of trade disadvantage through an appropriate system of export taxes, the quantity of exports will have to be much higher to earn a given amount of foreign money. Thus through devaluation, we may not get larger export earnings of foreign currencies and still we might have to export larger quantities of goods. Other things remaining the same, this factor by itself would accentuate the scarcities of commodities within the country and will lead to price-rise. Secondly, imports would become costlier in terms of rupees and hence wherever we have not nullified the rise in the import prices by appropriate subsidies, prices of imported goods would rise and will, in turn, raise internal prices. Hence, the policy which will be necessary to avoid inflationary pressures would consist of two sets of measures: *(i)* one type of measures which will be necessary to nullify the price effects of devaluation by an appropriate system of export taxes and import subsidies. Thus when we take these measures, we are in fact introducing the old parity of the rupee by the backdoor. Our analysis indicates that in substantially large sectors, we will have to nullify devaluation by such measures if we do not want to lose by it; *(ii)* The second set of measures which will

be necessary to counteract the remaining inflationary effect of devaluation and which are necessary also from a wider contexts as well, will consist of all measures to curb non-essential consumption and unproductive expenditures so that the gap between normal saving of the economy and its investment and defence expenditure which has widened in the course of the last five years is bridged. In fact, the appropriate remedy for us to cure the system of inflationary pressures as well as payment disequilibrium is to bridge the gap between normal (*ex-ante*) saving and capital formation and defence expenditure of our country. Thus, the whole approach to our balance of payments problem through the system of relative prices seems to be side-tracking the basic cause underlying our payments disequilibrium.

The balance of payments disequilibrium can be studied with reference to the saving-investment approach based upon the national income theory. For we can say that for the maintenance of monetary equilibrium in an open economy the following condition should be satisfied:

$$\text{Exports} + \text{Investment} = \text{Imports} + \text{Savings}$$

Here, we must interpret savings and investment as *ex-ante* magnitudes. From the above equation we get:

$$\text{Investment} - \text{Savings} = \text{Imports} - \text{Exports}$$

Positive Gap

Thus a positive gap between home investment (which can be interpreted to include all currently unproductive expenditure other than consumption expenditure) and the savings (which means *ex-ante* savings arising normally in the system at a given level of prices and a given pattern of income-distribution) has to be matched by equivalent positive gap between imports and exports, if monetary equilibrium is to be maintained. Thus, an economy where investment outruns the savings (normal *ex-ante* savings) suffers from internal pressure on prices on the one hand and an external pressure on the balance of payments. During the Third Plan it is this type of mechanism which has prominently worked in our country. Due to increased defence re-

quirements and growing development needs the gap between our investment and saving widened sharply so that it was very difficult to fill it up just by an import surplus through foreign aid. It is this investment-saving gap which has caused the inflationary pressures to accentuate in our system and at the same time has led to the pressure on our balance of payments. Thus inflation is not the cause of our balance of payments disequilbrium, but inflation and payments disequilibrium are the joint results of the investment-saving disparity in the economy. If this analysis is correct, balance of payments disequilbrium cannot be resolved through bringing about changes in relative prices. Both inflation as well as balance of payments disequilibrium can be adequately tackled only by approaching them as problems arising out of the investment-saving disparity. These general effects of investment-saving disparity are accentuated by the stagnation of agricultural production which we experienced during the course of the Third Plan period. Hence the appropriate remedy of this situation is to take measures to raise internal savings through appropriate curbs on non-essential consumption and to reduce investment by cutting down all sorts of unproductive expenditures. Only by achieving a balance between investment and saving by such measures, and only by increasing agricultural production, we will be able to relieve the inflationary pressures as well as the balance of payments disequilibrium.

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Paper IX

DEVALUATION AND EXPORTS STRATEGY

M. A. DESHPANDE

DEVALUATION OF THE RUPEE is expected to increase exports substantially and decrease imports. It is a simple but straightforward method of influencing the imports and exports and thus achieve an equilibrium in the balance of payments which now shows a big gap.

Export Structures of India

Simply as a sequel to devaluation, exports will not increase significantly nor imports fall so. The reasons are not far beyond to seek. As to our exports particularly the traditional goods, except for textiles, there is little scope for expansion. While tea exports have been falling in the recent years, jute is facing static demand and if technological factors are considered, there is fear that jute may eventually be replaced by synthetic jute. The textile industry, however, if the plans of modernization are carried out which they badly need, can make some headway.

Among the non-traditional goods, engineering goods are considered as a suitable candidate. Here too, any student of this industry will point out that the industry has some of its own problems. The raw material shortage has hit this industry con-

siderably. The units are not working on single shift basis today, though they were envisaged to work on double shift basis and the capacities were planned and expanded with this view. Because of the smaller scale they work on, they are unable to reap the economics of scale. For exporting in international markets, mass production units are needed to step up production at lower cost of production. Added to this difficulty, there are other problems like licensing, labour troubles, power shortage and higher and steeper taxation doses.

W. B. Reddaway, who made a penetrating study of the Indian economy remarks:

> The growth of the exports is unlikely to be very rapid in absolute terms, since India will not be able to sell much abroad until she has fully mastered the production problems and is able to offer a supply which is reliable both in quantity and quality.*

Exports which were stagnant at about Rs. 650 crores in the two Plan periods, have shown some signs of improvement only in the Third Plan period, as may be seen from the Table below. The Table also points to the increasing gap in our foreign trade.

EXPORTS AND IMPORTS IN THE THIRD PLAN

(Rs. in crores)

Year	*Imports*	*Exports*	*Balance of trade*
1961-62	1107.1	679.7	—427.4
1962-63	1135.6	713.6	—422.0
1963-64	1222.9	793.2	—429.6
1964-65	1314.2	816.3	—497.9
1965-66	1350.5	809.6	—540.89
Total Third Plan	*6130.2*	*3812.4*	*—2317.8*

No doubt the exports in the Third Plan have not only increased but have also become more broadbased and diversified,

* W. B. Reddaway, *The Development of Indian Economy*, 1962, p. 29.

compared to that of First and Second Plan. But the basic character of our exports that they are yet more of raw material and semi-manufactured character has not much changed. The engineering goods have increased their exports from Rs. 7 crores to Rs. 8 crores in 1961-62 to Rs. 20 crores by the end of the plan.

Considering the direction of exports, it has to be agreed upon that though our exports have, no doubt, increased greatly to Eastern Europe and USA, the countries of Africa, Latin America seem to have not been explored for export markets, as may be seen from the Table below.

(Rs. in crores)

Area	*Average Second Plan*	*Average of Third Plan*
USA	108.21	150.53
East Europe	35.71	113.27
ECAFE	134.83	163.43
Latin America	18.72	15.27
Africa	47.49	52.18

The problem of stepping up of exports is also linked with the problem of the extent to which our exports are elastic to price changes. This depends on many factors, such as the nature of our export products, their share in the world market and our rivals in the international market. Our exports, at least about 70 to 80 per cent, are by and large agriculture-based and the progress made in increasing cotton, sugar, raw jute, oilseeds etc., has been unimpressive compared to that of the other countries. Again two-thirds of our exports are absorbed into by nine countries and three-fourths consist of a dozen commodities. *It is also revealing to know that our exports as percentage of world exports have declined from 2.0 per cent in 1951-52 to 0.9 per cent in 1965-66.*

The following Table will bring out the main features of our imports over the last decade and half.

CHANGING STRUCTURE OF IMPORTS

(Rs. in crores)

Period	*Capital goods*	*Industrial goods*	*Consumer goods*	*Unclassified items*	*Total*
First Plan					
Average	151.65	346.37	176.96	48.42	723.40
% Share	20.9	47.9	24.5	6.7	100.00
Second Plan					
Average	282.85	458.42	171.53	63.65	976.45
% Share	29.0	46.9	17.5	6.6	100.0
Third Plan					
Average of four years	416.47	488.85	226.29	50.61	1182.22
% Share	35.2	41.4	19.1	4.3	100.00

SHORT-TERM MEASURES

Adjustment in the Export and Import Duties

Consequent upon devaluation, far-reaching changes are needed in the rates of export and import duties, to harness the benefits of devaluation without severe dislocation of the economy. The rupee cost of the imports should go up by 57.5 as the currency is devalued. The rupee cost of imports will not, however, increase by an uniform rate, as rates of import duties are charged as:

(in per cent)

Imports	*Old rates including regulating import duty of 10%*	*New rates (after devaluation)*
Machinery	45	27½
Primary raw materials	50	27½
Other raw materials	70	50
Intermediaries	70	50
Agricultural machinery	25	15
Consumer goods	110	100

As the new rates of import duty will be *calculated on the new rupee value of imports,* the reduction in import duties will have very insignificant effect on the overall rupee cost of imports. This precisely means though rates of import duties have been reduced, *the actual incidence of duties,* instead of falling, may rise. This incidence of import duties is likely to affect the imports under 'other raw materials' and 'intermediaries.'

The imports for latest year amounted to Rs. 1,400 crores. Excluding Rs. 300 crores covered by P.L. 480, the remaining imports of Rs. 1,100 crores will jump up to Rs. 1,732 crores after devaluation. If about Rs. 350 crores due to import duties are added, the total cost of import comes to Rs. 2,082 crores. This is significantly higher than the figure prior to devaluation and the importers have to search for this extra money. The banking sector and the Reserve Bank of India must assist in meeting the working capital requirements of the industrial sector which were hitherto ruthlessly curbed by stiff credit policy will be buoyant now, and avail themselves of import liberalization policy. The approach to import substitution seems to originate from the costly imports, as a sequel to devaluation. The imports have been made very costly mainly because

(*i*) The importers should compensate the loss due to 'export subsidies' implied in the devaluation;
(*ii*) Import duties should also support budgetary surplus.

It is argued whether such a heavy burden can be borne by our importers. Devaluation implies minimum or no import duties at all. The very existence of the import duties implies that present degree of devaluation being not adequate gives room for speculation of second devaluation. The Government should see that such a fear is baseless. Secondly, the prices will be pushed up and add to inflationary pressures. In the long run the duties should be scaled down.

Export Duties

Criticism is very much voiced regarding the export duties levied on a number of commodities, many of which are major foreign exchange earners, such as jute and tea. It is said that

much of the benefit of devaluation would be neutralized. The Finance Minister had said that these would be levied mainly to see that our export prices do not fall very much. They are also so levied as to provide some edge for our exports in the international market.

The export duties, however, have achieved one objective and that is it has kept the other rivals at bay. Neither Ceylon nor Pakistan has devalued, though no one can guarantee of their stand for the years to come. There is already talk in Pakistan to amend the export bonus system suitably. Therefore, the export duties need continuous watch and adjustments if circumstances demand so.

Excise Duties

The exports do not increase also because the exporters find it more profitable to sell in the highly sheltered domestic market. This calls for making exports more attractive by curbing the domestic consumption through indirect taxes. Already a former Finance Minister has recommended for the levy of excise duties to encourage exports.

Let us ask ourselves. What is the lesson we have learnt by indiscriminate levy of excise duties? The greatest mischief of this device has been a steep rise in costs of production. For example, India was the cheapest producer of steel some ten years ago, but now it has been the costliest one. The engineering industries whose main raw material is steel, are finding it very difficult to control the rising cost, which is beyond their control. The excise and other duties on the average form something like 40 to 50 per cent of the final price. There is justification for a greater relief in the excise duties which are mounting and throttling the production and chasing the prices further. However, it is not to deny that some restraint is required on rising demand, and the same can be accomplished on selective basis.

At present drawbacks of customs and excise duties are allowed. They should continue in the future, also, since they work as incentive to export them rather than sell in the domestic market. It is admitted now that the export incentive schemes did not work satisfactorily because they were changed frequently and the benefits were not adequate enough, especially when

the exports had to observe so many tedious formalities.

The frequent changes gave room for uncertainties and the hopes for entering into international contracts for, say, exports of engineering industry were greatly nullified. A Seminar held at Calcutta in 1964 deplored 'the inordinate delays in fixation of drawback rates and settlement of claims even after the rates were fixed.' The tax credit certificate scheme was reported to be 'cumbersome and the benefits are too small to make a real impact. In any event, such relief is indirect and takes a long time to be felt.'

SOME LONG-TERM MEASURES

Formulation of the National Export Policy

A very carefully calculated export policy in the proper perspective has to be formulated. It is regretted that even after the devaluation, no clear picture is emerging of our possible exports which means that no plan (alternative) was thought of in regard to the factors that might influence our exports. While the Prime Minister has said that our exports will treble within the next ten years, the planners have given a new figure of Rs. 9,000 crores as the target for the Fourth Plan, as against Rs. 5,100 crores, originally estimated. A simple arithmetic operation i.e. increasing Rs. 5,000 by 57.5 per cent will give Rs. 8,000 crores and then add Rs. 1,000 crores. This is the minimum that is required to make any sense out of devaluation. Last year, at the time of the revision of exports target from Rs. 3,700 crores to Rs. 5,100 crores, Union Deputy Finance Minister had promised to frame a national export policy similar to the Industrial Policy Resolution. Such a national policy should have an integrated approach to augment our exports. The National Development Council is likely to move such a resolution shortly. The resolution must touch upon all aspects of export maximization. In the absence of such a clear-cut policy, uncertainty looms in. What should be our annual and five-year targets based on some assumptions? Where S.T.C. or any other body will assist and in what way? How could State Governments function in assisting the task of augmentation of exports? The State Governments also have to play an important role, since they levy a large

number of indirect taxes. It has to be decided how much per cent of production say in specific industries should be earmarked for exports and so on. Policy has to be framed in the light of our past experience and to influence the structure and direction of exports in the international markets as per our requirements.

Increasing the Production-base of our Industry and Agriculture

Low production and productivity affect adversely the prospects of exports. Our exports, as we have already seen, are more of agro-based ones and unless production in agriculture increases the chances of larger exports are bleak. I have already quoted Professor Reddaway where he has touched this aspect, that we must master the production problems of the industry. Increased production will bring down costs of production (through economics of scale) and prices. The rising domestic prices affect the prices of export industries also, since our exports constitute very small portion of the national income. Our Finance Minister has already admitted that our exports were out priced, since the prices in India increased by 80 per cent compared to 27.2 per cent in the UK, 9.7 per cent in USA, 10.3 per cent in West Germany, 18 per cent in Pakistan, 34.5 per cent in USA and 3.5 per cent in Burma. The productivity in agriculture per acre per man has made very little progress in our goods. Our yields per acre are half or one-third of what has been achieved in developed countries. Failure in agriculture has not only caused the rise in food prices but has starved our industries based on agriculture. By applying scientific methods and suitable distribution policy, the supplies can be maintained uninterrupted.

Industry

In the recent years, indiscriminate expansion of capacities has added to the idle capacity than to production. The Engineering Industries, which are expected to enter the exports market are, in fact, hard hit (see Table on facing page). The following quotation will be quite relevant in this context:

> The steel, for instance, if during the last ten years our planners and Government had, as we urged them to, laid less emphasis on the production of ordinary carbon steels and

CAPACITY UTILIZATION IN INDIAN INDUSTRIES, 1963

(percentage utilization)

Name of the industries group (Engineering)	*Number of industries*	*Total no. of units*	*80 to 99 per cent*	*100 per cent and above*	*60 to 79 per cent*	*Below 60 per cent*
1. Tools	2	12	—	2	—	—
2. Light Electrical Engineering Industries	13	132	10	2	—	1
3. Instruments	9	41	—	3	3	3
4. Heavy Mechanical Engineering Industries	4	33	2	1	1	—
5. Light Mechanical Engineering Industries	30	310	4	10	7	9
6. Electrical and other Engineering Industries	10	283	3	3	1	3
7. Machine Tools	13	128	1	9	1	2
8. Automoble and Anciliaries	34	211	4	7	7	16
TOTAL	115	1150	24	37	20	34

> more on special steels required by the engineering industries, large amounts of precious foreign exchange would have been saved. There must be no further reckless licensing as in the past of non-essential projects, requiring raw materials and components production of which neither existed nor was planned.*

The task of export target must become a sacred duty of every one of us. At the time of the devaluation of currency of Europe in 1949, many were sceptical of this measure. 'How can we export to USA, was a problem. But the Governments embarked upon aggressive export drive. European businessmen went to USA to explore the markets and the trade which was unfavourable during 1950-54 turned out to be favourable during 1955-59. Exports to USA trebled and a wide variety of industries launched an export programme. Similarly the Dutch trade unions went so far as to accept a wage cut of 5 per cent as their contribution to the solution of the balance of payments difficulties of the Korean crisis of 1951! Given will and encouragement, why our exporters should lag behind?

The problem of exports in India is thus a complex one requiring a combination of measures. The devaluation has been successful in jerking our sick economy. The follow-up measures are expected to restore its internal vitality and external viability.

* From a recent speech of Shri J. R. D. Tata.

DEVALUATION AND EXPORTS—A MANAGERIAL APPROACH

PARESNATH CHATTOPADHYAY

THE GOVERNMENT decision to devalue the Indian currency as announced on 5 June 1966, has remained a bone of contention since then, particularly its rationale has been much a matter of intellectual excitement. The present discussion does not attempt to contribute to that debate. Its modest aim is to highlight the need for adequate management response in the context provided by devaluation for augmenting India's exports. This is in a way an issue independent of devaluation; it is also integrally connected with devaluation because it is the exporters who operate the monetary mechanism in the market, internal or foreign, for foreign exchange and all that.

There is no controversy on the fact that the rupee was suffering from a disequilibrium. Whether this was fundamental of only a transitory phase in a developing economy is another matter. That devaluation seeks to rectify the disequilibrium is also beyond dispute. More important than this is the aftermath of reality which we have to consider. Devaluation and other cognate decisions taken by the Government have put the limelight on non-traditional exports, initiating a spurt in favour of change in the composition of our exports from low-added-value

products to high-added-value products. The shift in the composition of India's exports is already manifest in the sense that our present export list includes items that were not there even five years earlier or that we are now operating in markets which were not in the list earlier. But the share of new items is insignificant as yet. The Fourth Five-Year Plan has in view a significant shift in the composition of Indian exports and the present predominant position of agriculture and animal-based products is to yield place to engineering goods and other high-added-value products. The skewness in the distribution of individual products in favour of traditional items continues, from which breaking away has become imperative. In causing the shift in the pattern of our exports, it has become necessary that much greater sensitivity to the challenge of the change was shown, more than the others, by those who are managing the exports.

Before we come to this question again, let us consider some basic facts. A major part of the strain arising out of unfavourable balance of payments is because of the tremendous pressure on imports. The Table below[1] shows the emphasis on capital goods.

AVERAGE PERCENTAGE OF IMPORTS

		First Plan	*Second Plan*	*Third Plan*
1.	Capital goods	20.9	29.0	35.2
2.	Intermediate goods	47.9	46.9	41.4
3.	Consumer goods	24.5	17.5	19.1
4.	Cereals	15.1	11.9	11.6
5.	Cashewnuts	0.6	0.7	0.9
6.	Consumer goods other than cereals and cashew	8.8	4.9	6.6
7.	Unclassified items	6.7	6.6	4.3

* SOURCE: *Basic Statistical Material*, Vol. X. December 1965, Office of the Economic Adviser, Government of India.

[1] S. L. Sharma, 'Shifts in Trade Policy' in *Foreign Trade Review*, Vol. I, No. 2 p. 168, published quarterly by the Indian Institute of Foreign Trade, New Delhi.

The compulsions of rising imports reflect themselves on the exports will be in the ultimate analysis through either less and less imports or more and more exports over the years. In a major way, our imports are also linked up closely with building up our export capacity in cases where imports relate to raw materials spares and components. In these cases, which comprise some of the important non-traditional items, the cost of import content of the products will be higher and unless efficiency improves considerably, price rise may not be escapable. The emphasis is thus on import substitution and more efficient utilization of the imported materials. The import content is there even in some of the traditional items.

In the conditions mentioned heretofore, profitability from exports acquires particular significance. In the cases of commodities where foreign price remains the same as before the exporters are in a position to earn higher profits in rupee terms provided the import cost of materials etc. and cost of transport of exported goods do not increase more than proportionately to eat up the otherwise possible profits. Where exchange prices record a fall the story is different. One particular point that should be relevant here to mention is that in the context of exports, devaluation exercises different types of influences on different products. Dr Manmohan Singh[2] mentions three groups of commodities in this respect. They are (1) Devaluation does not alter the export prices in terms of local currency. In such cases, we may note, corresponding export duty would be helpful to keep these prices in terms of foreign exchange also constant. (2) Devaluation alters the export prices in terms of local currency and results in higher profit for exporters if the foreign price is constant. In such cases, to enable reaping full benefits, there must be elasticity of demand in the foreign markets and elasticity of supply in the internal economy. (3) In regard to the marginal export items of India their prices being controlled by the international standards, as a result of devaluation the export prices of these items in terms of local currency will show rise. These items will naturally receive a fillip on devaluation.

Devaluation to be successful in giving the necessary boost to our export effort must ultimately depend on greater manage-

[2] *India's Export Trends* (Oxford, 1964), pp. 323-26.

ment alacrity which is discussed in Part II of this Paper.

II

In the past, the major area in which India's export effort has been found desperately lacking is that of management and organization of export at the enterprise level. The purpose of this section is to highlight the elements that require streamlining for meeting the challenge of the new situation created by devaluation. Indifference on myopia would be very costly from our point of view. The opportunities created by devaluation would go amiss and the requirements of dynamic growth would go unattended.

Management as a function involves four essential ingredients, namely, planning, co-ordination, motivation and control. These are not mutually exclusive though identifiable. The act of setting objectives, adjustment and integration of objectives with reference to the cognate work programmes, the manner and ways of implementation of objectives and revision, modification and alteration of objectives in the light of circumstances is in a nutshell what planning means. Co-ordination implies close inter-connection of the different factors and forces of production, determining factor proportions, factor balance and process balance, fixation of functional responsibility and communication of the objectives to all work-centres in the organization. Motivation underlines activizing these factors and forces of production towards realization of the objectives. The essence of motivation is to ensure teamwork in action. Control means guiding and regulating these factors and forces of production in such a way that the whole action remains centripetal to the objectives, more particularly to the predetermined norms and manners of performance. The management function thus underlines deliberate action of turning potential energy of the production factors and forces into kinetic work programmes of everyday relevance.

It is required to appreciate that the management function with regard to increasing foreign exchange earnings through exports can be viewed from different standpoints with respect to the effects of devaluation. A tentative classification of these viewpoints may be as under:

A. (*a*) Products with import content of raw materials;
   (*b*) Products from imported capital equipment, spares, stores and technical know-how;
   (*c*) Products from concerns with foreign financial collaboration;
   (*d*) Products from concerns with liability to remit money abroad.

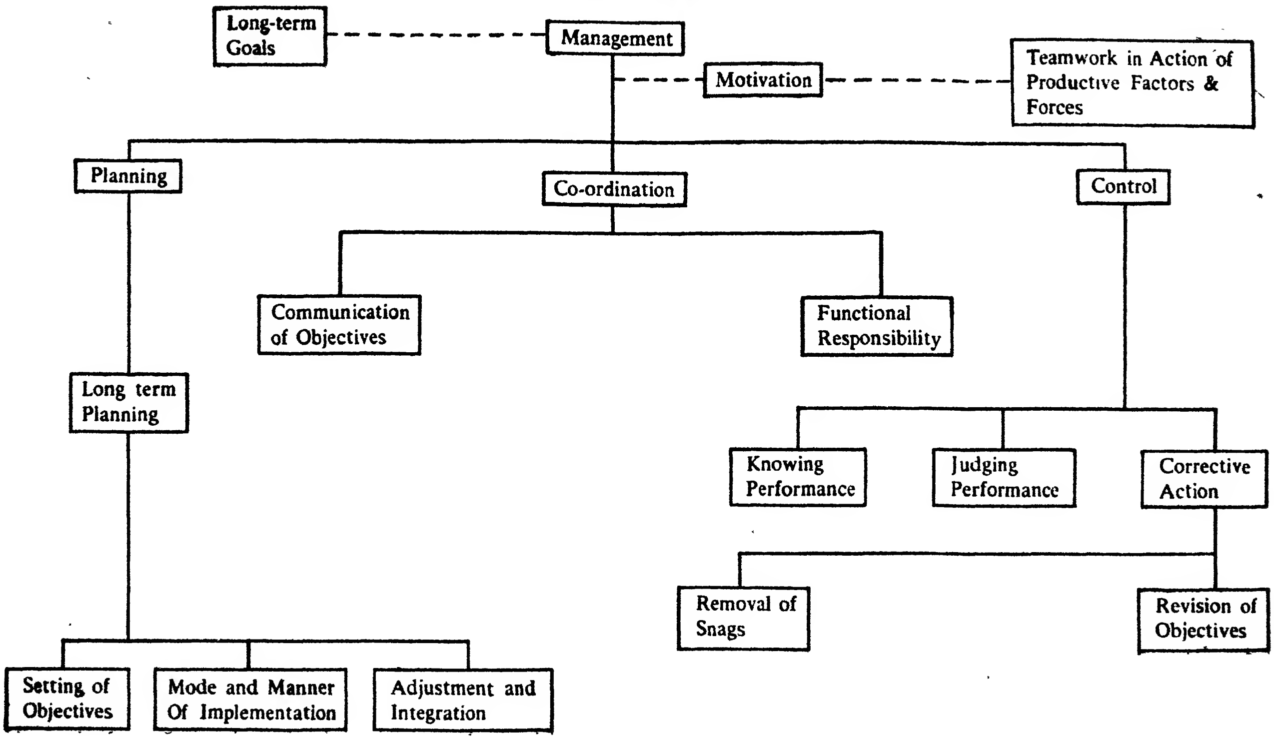
B. Units collaborating abroad, exporting managerial and technical know-how.

C. (*a*) Export houses;
   (*b*) Trading Concerns.

Management, in the new conditions is primarily concerned with revitalizing itself in the context of several challenges that organizations would face with regard to export of different products. A major task will be to organize productive functions on more scientific lines, covering the entire functional aspects of the enterprise. The dynamism of an organization primarily lies in its structure itself and unless the structure is strong and flexible enough, the organization loses its power to expand or adopt to changes with facility. The organization of export effort in an enterprise has to be dynamic and sensitive enough to react in time.

A vital point in the reorganization of export effort is proper manning of various cadres in the export organization of the enterprise. In many organizations now engaged in export, functional differentiation of export is absent. The people in charge of exports are low in the hierarchy and do not have adequate discretion. The designation Export Manager is not very common. Even where he is there, his powers seem rather limited particularly in manufacturing-exporting-organizations. Knowing and judging export performance have already assumed cosiderable significance at the operational level in so far as the economic aspects are concerned. There are several techniques evolved from experience for this purpose. It is necessary that their application was scientific. In assessing export performance, particular attention is required to be given to the long-term interests of trade. In most of the export products competition is very keen not only with reference to other producers of other countries but also to various substitutes. It is observed that the rising

DIAGRAM I



Long-term Goals
Management
Motivation
Teamwork in Action of Productive Factors & Forces
Planning
Co-ordination
Control
Communication of Objectives
Functional Responsibility
Long term Planning
Knowing Performance
Judging Performance
Corrective Action
Removal of Snags
Revision of Objectives
Setting of Objectives
Mode and Manner Of Implementation
Adjustment and Integration

DIAGRAM II

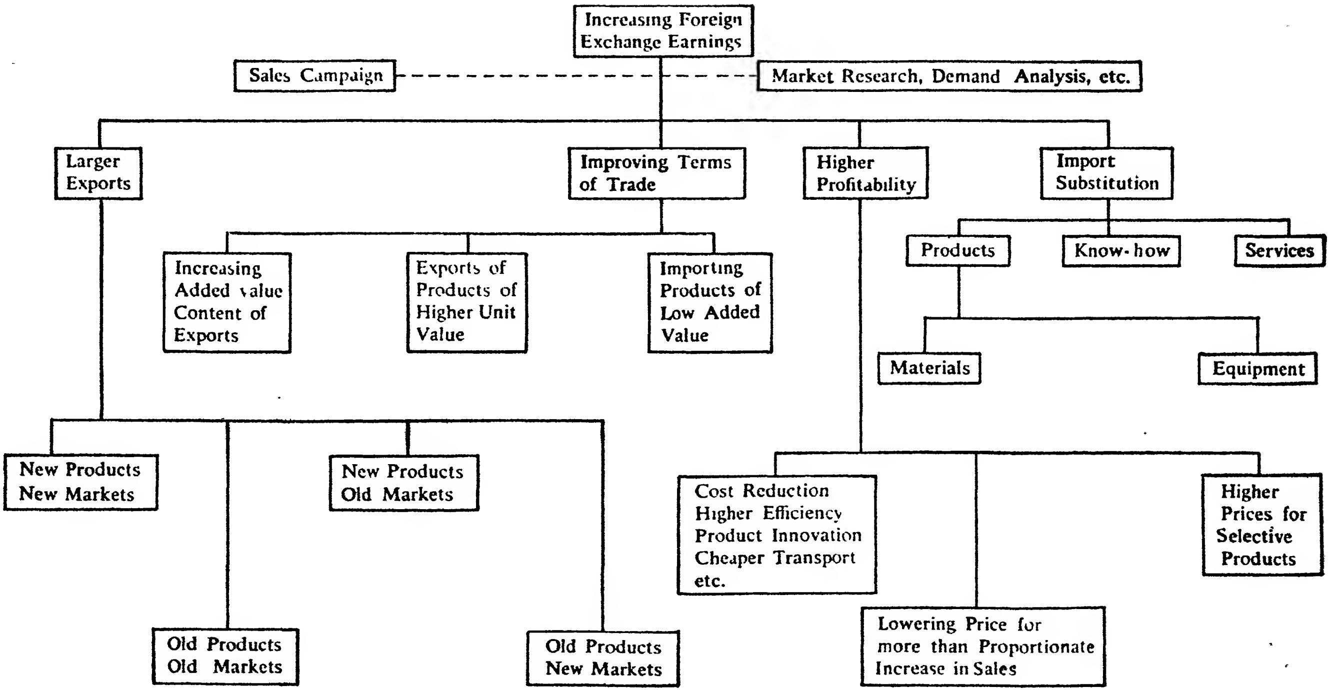
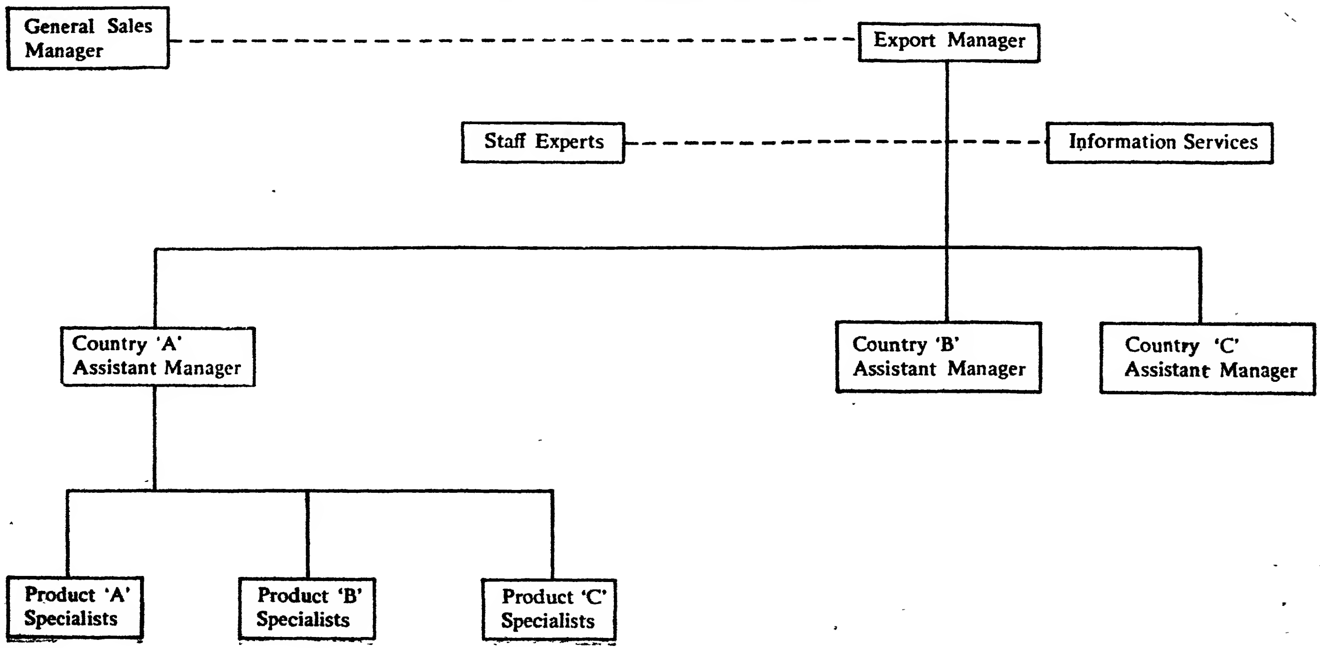

Increasing Foreign Exchange Earnings
Sales Campaign
Market Research, Demand Analysis, etc.
Larger Exports
Improving Terms of Trade
Higher Profitability
Import Substitution
Increasing Added value Content of Exports
Exports of Products of Higher Unit Value
Importing Products of Low Added Value
Products
Know-how
Services
Materials
Equipment
New Products New Markets
New Products Old Markets
Old Products Old Markets
Old Products New Markets
Cost Reduction Higher Efficiency Product Innovation Cheaper Transport etc.
Lowering Price for more than Proportionate Increase in Sales
Higher Prices for Selective Products

DIAGRAM III

EXPORT ORGANIZATION CHART



costs and prices of some of the traditional export items of India have resulted in the past encouraging substitutes of different kinds for similar uses. Keen competition in the foreign markets also requires aggressive sales effort and in this product design and product quality command considerable importance. Diversification of exports both with reference to the product range in the same market and in the different markets is another task that deserves attention. It is also necessary in this context to draw export plans for individual enterprises and develop managerial information services for this purpose. Such services include marketing research, demand analysis, brand analysis, advertising and its effect in terms of pay-off and also after-sales service.

It is essential to establish close co-ordination between production and export efforts. In foreign markets demand shifts, changes in fashions and consumers' tastes are quite frequent. It is necessary that management remains awake to these questions. When the demand in the market is created and supply afterwards is not adequate to meet the demand an awkward situation arises which apart from demolishing the good effect generated by the advertising campaign etc., creates a psychosis among buyers. Strict adherence to product specifications of quality and content is a *sine qua non* of sustained export performance at a high level. The image created in the foreign market is an extremely important factor in the total export effort of individual enterprises.

For a sound export policy and strategy at the enterprise level there are several factors which require particular consideration. The primary factor in this connection is proper organization of export effort within the enterprise. The charts at the end of the paper attempt to show the elements of management, the factors contributing to higher exchange earnings and the departmentation pattern of the export section of an enterprise. The requirements of a proper organization are adaptation to the changes that take place, initiating changes and creation of agents of change within the organization as well as taking benefits from services organized outside. The external organizational services have assumed considerable importance in this connection, not only with regard to stimulating the enterprises with information of the required kind at the required moment but also in other

aspects of trade and trade contracts including pricing. The need for proper organization of consultancy services for this purpose should be considered seriously.

Secondly, adequate attention is necessary on the product meant for export. The quality and content of the product with reference to the prices at which it is offered requires considerable scientific attention. Product engineering has already made its mark in advanced countries as an extremely useful staff function of which management would like to take benefit. The product must be attractive to command usefulness as well as respect. The advance of packaging as the science and art of catching the imagination of the consumer has gained considerable ground in recent times. In this country increasing attention is being paid to packaging not since long. Durability of the product depends also on the durability of the package and at the same time its cost must not be such as makes the product unattractive in price. In this regard, the establishment of the Institute of Packaging in Bombay should be viewed with encouragement.

Thirdly, marketing of Indian export products abroad by the enterprises has left much to be desired. Sustained advertising campaigns of course become a drag on the foreign exchange resources of the enterprises but complete withdrawal from advertising in international markets leaves the products in the dark. Apart from advertising, there are other marketing efforts which also need strengthening at the enterprise level itself. Most enterprises in this country do not consider maintenance of sales organization abroad economicaly feasible. However, in a sustained export campaign the role of maintenance of sales organizations in foreign markets by individual enterprises should be recognized. It is true that in many cases, the exports of an individual enterprise may not justify maintenance of a sales organization abroad. However, it is possible for concerns with large exports or export potential to maintain such organizations. In some cases, it is also feasible to have such organizations for a group of such concerns or for export houses.

Fourthly, application of scientific techniques like mathematical models, operations research and network analysis, techniques of control like budgeting and standards is called for with a view to reducing various overheads, striking an optimum level of export quantum, determining the optimum size-lots of consign-

ments, sizes of packages etc. It must be noted here that scientific techniques by themselves are not enough. These must also be applied scientifically for maximum results. It is pertinent to suggest for example, breaking up the total sales shown in the accounts of these concerns in terms of sales in the domestic markets and sales abroad. Determination of export profit in the present circumstances leaves much to be desired in view of the fact that the costing and pricing of export products are totally mixed up with those of domestic sales. In the circumstances it is possible that the maximum advantage of the profits arising from sales abroad are not being fully taken by these concerns. The recent provision for audit of cost accounts under Section 233-B of the Indian Companies Act, 1965, should be taken advantage of, in determining the costs and prices of the export products, other than primary commodities. It is suggested that the certificate of the cost auditor be taken as a conclusive documentary evidence of profits from sales abroad for tax exemption, for granting rebate and for other purposes. Management's role in this context must necessarily be more imaginative than it is now.

Last but not least, it is necessary that the export organization was manned by persons properly trained and educated. This is important for those who decide on policy and also those who execute it over a period of time. In many Indian concerns the general attitude is that the top management is immune from this need and that training etc., would be required only for middle and lower level management. The major emphasis is put on one's own experience. However, it is urgent that not only should the top management understand the requirements of circumstances in formulating policy, it should also know the language of management in communicating down the line and in receiving such communication from below. In the words of Lawrence Appley,

> When a person is assigned to a job, he should be given all possible help in the form of the best available experience as to how that job should be done. This is what is called training and education.

Tracing the sources of export motivation of individual enter-

prises one can easily suggest that devaluation has not been a substitute of export incentive schemes. While devaluation is a general phenomenon, the incentives take account of the performance of each enterprise. Taking the urgency of increasing and streamlining our export in view, it is necessary that some of the incentive schemes were revived. In exactly what form they should be is a matter of detail but their necessity is felt keenly. It has also become essential that foreign exchange expenditure for promotional purposes of enterprises was allowed more freely.

(The views expressed in this paper are the author's own and do not have anything to do with the Institute in which he is working.)

Paper XI

DEVALUATION AND IMPORT SUBSTITUTION

G. L. BANSAL

THE NEED FOR import substitution arises from the urgency of conserving our limited foreign exchange resources and also of effecting a fuller utilization of indigenous resources. The devaluation of the Indian rupee is supposed to provide, *inter alia*, some impetus to import substitution. The Minister of Finance, in his Special Broadcast on 5 June, observed:

> Devaluation will also quicken the pace of import substitution. The cost of imports in terms of rupees will now automatically go up. This will make it really worthwhile and attractive to invest in those of our industries which produce goods which are still being imported. Enduring encouragements to both exports and import-saving activities will enable us to move faster towards self-reliance.

The reasoning behind the contention that devaluation will provide encouragement to import substitution is based upon the assumption that it gives a degree of protection to indigenous industries. Imports will now be costlier to the extent of 57.5 per cent. This is in addition to the somewhat higher incidence of import duties. When imported goods become costlier, those who

use them are expected to turn to indigenous substitutes. Import substitution as a result of higher cost of imported raw materials and intermediates nevertheless implies that the impact of the higher cost is less than the c.i.f. cost of finished products and also that qualitywise the indigenous product is as satisfactory as the other if not superior.

2. Import substitution by definition means a reduction in the reliance on imports as a result of increase in domestic production. Such reduction can be in absolute terms or in relative terms. In absolute terms the overall import bill is bound to go much higher than what it was in the pre-devaluation period. It is therefore, in relative terms that import substitution is likely to be facilitated as a result of devaluation. Import substitution may be said to take place when new output is generated to replace imports as also when new materials available indigenously are utilized in preference to items which are relatively scarce and on which the dependence on imports is large. The former takes place automatically when production expands. The latter is conditioned by technological factors.

3. The progress of import substitution so far, in this last sense, has not been very significant, though as a result of the diversification of the Indian economy and the commencement of production of a large number of new items a degree of substitution may be said to have taken place. While import substitution in the sense of reducing imports as a result of increased production in the country, has been an important factor in our policy, it has, in its technical sense, acquired special importance only in recent times, when foreign exchange difficulties became pressing. In particular, efforts were directed towards conservation of non-ferrous metals, a more rational use of scarce materials and greater reliance on machinery, parts and spares made indigenously. Based upon the technical possibilities, steps were also taken to produce in the country itself a wide variety of basic raw materials which were being traditionally imported.

4. Devaluation has affected our thinking on many aspects of import policy. It is rather early to judge the full impact of devaluation on import substitution. The presumption that devaluation will induce import substitution in a way applies more to a free economy than an economy like ours which is subjected to quantitative restrictions on imports. These restrictions have

come to be adopted in India for a long time now ever since the foreign exchange position started becoming difficult. Tariff protection under such conditions has been used as a less effective instrument to protect indigenous industries *vis-à-vis* quantitative restrictions. A liberalization of the productive forces of the economy is bound to make the tariff mechanism a more effective instrument of policy. Devaluation does not, however, do away with the need for restraints on imports and it does not imply that our imports will be liberal in the sense of being free.

5. Import substitution is to a great extent conditioned by a rational allocation of foreign exchange resources to meet the requirements of existing industries as also the creation of new industrial capacity. This depends upon the import and tariff policies. The import policy should necessarily be oriented towards allowing imports of items which will facilitate the development of import-saving industries. It should also provide encouragement to entrepreneurs to undertake manufacture and processing of goods from the primary stage so that only basic raw materials are imported in preference to finished or semi-finished products. Looked at from this angle liberal imports of the very basic machine tools, raw materials and scarce metals is an indispensable condition for import substitution. Consequent on devaluation, Government announced on 22 June a liberalized policy for meeting import requirements of 59 priority industries. It logically follows that in these industries the liberalization will enable the existing units to expand production by utilizing their installed capacities more fully and thus help import substitution.

6. The full effect of devaluation on the growth of import substitution industries depends upon the net impact of the higher cost of imports on indigenous production. The higher cost of imports of machinery and raw materials will be directly reflected in the cost of production of items based upon them. To the extent the net increase in cost is less than the c.i.f. cost, import substitution will be facilitated. When devaluation was announced, the rates of import duties on some items were reduced. However, the actual incidence of the reduction is much less than the reduction in the rate of duty and in many cases it is higher. We may refer to the case of reduction in duty first. The duties including regulatory import duty in the case of

machinery items was reduced from 45 per cent to 27½ per cent but the net incidence of these duties was a marginal decline from Rs. 45 to Rs. 43.31. The position in regard to items like primary raw materials, intermedites etc. is such that, by and large, there have been increased incidence of duties. These will have varying effects on import substitution effort. In some cases they may be instrumental in encouraging the production of some raw materials and intermediates, provided that other necessary steps are also taken simultaneously. On the other hand, the industries using such raw materials may now have to incur higher costs and to that extent import substitution efforts may receive some setback.

7. Though devaluation is expected to provide added protection to indigenous industries, protection by itself is but only one of the pre-conditions for import substitution. Many of our industries, due to various economic and technological factors including scales of operation, types of machinery installed, processes used, are not always in a position to stand competition with industries elsewhere. The first measure, therefore, that is required to sustain a higher rate of import substitution is the removal of this disparity. In other words, the conditions under which the Indian economy is operating has to be changed and this is possible only through a liberalization of the controls on production, distribution, pricing, capital investment and so on. It follows that the process of establishment of industrial units under the Industries (Development and Regulation) Act should not only be streamlined and speeded up, but freed as far as possible, the capital market should be revived and redundant controls such as those on raising new capital, diversification of investment and on pricing and distribution etc,. be done away with.

8. As the economy has become more complex, new and growing import needs have emerged. When older demands were satisfied, there were new demands to be cared for. To some extent, the lag in import substitution occurred mainly on account of certain elements of policy. The fiscal devices did not induce a larger pace of import substitution. For instance, there were certain anomalies in the pattern of import duties, In many cases lower import duties are charged on more finished products as compared to the basic raw materials. Similarly, imports were made under 'turn-key' contracts executed on behalf of projects

in the public sector which leaves very little scope for the utilization of indigenous products. A large proportion of our import bill is made up of imports on Government account which do not appear to be subjected to any detailed scrutiny with a view to eliminating imports of those items which could be obtained from indigenous sources. Further, many unspecified items are being imported under various categories such as machinery, spares, raw materials etc. It is possible that capacity exists for many such items.

9. Import substitution has also been prevented, in a great measure, by the slow implementation of certain crucial projects such as those for pyrites, copper, zinc etc. which are scarce and on which we are largely dependent on imports. Sometimes on technical or ideological grounds the development of these scarce materials have been held up for indefinite periods. Yet another factor that has been impeding import substitution is the lags in industrial research and development of designing capacity in the country. Technological import substitution may be possible in some cases. For instance, 'aluminizing' in the place of 'galvanizing' is suggested. Similarly, many copper-based industries can use aluminium. But in regard to all these a common difficulty has been the virtual absence of indigenous designing capacity for machinery and equipment for utilizing the research results. In addition, industrial development has resulted in the use of a wide variety of standards and specifications as also products. For instance, in the case of dyestuffs innumerable varieties are being imported in the country though limited varieties can be used and for which indigenous capacity exists. Steel is another item in respect of which standardization of the sections used and a reduction of varieties may be possible without affecting the efficiency of end-uses adversely.

10. Another impediment to import substitution has been Government's purchase policy. Despite the growing defence requirements, very little has been done so far to associate the civil sector which is evident from the fact that since 1962, defence purchases from the private sector amounted to only Rs. 8 crores. Again, the lack of continuity of orders, and the smaller size of orders have prevented a fuller utilization of indigenous sources of supplies.

11. From the foregoing it is clear that devaluation is but

only one of the conditions which may provide a fillip to the efforts towards import substitution. To sum up, for attaining a larger degree of import substitution the following further steps are indicated:

(*i*) That the import policy be oriented towards the import of the essential items required by the economy to increase production.

(*ii*) That quantitative restrictions are intensified on import of items for which there is enough indigenous production to meet the requirements.

(*iii*) A thorough scrutiny is made of the import requirements on Government account, in particular of the public sector projects.

(*iv*) That the policy and procedural obstacles are removed for the the initiation of industrial capacity, diversification of existing production facilities and capital resources.

(*v*) That a well-conceived fiscal policy is adopted as to direct the flow of imports into those sectors where they are actually required.

(*vi*) That the tariff mechanism be made use of increasingly to direct the flow of imports and to provide the necessary conditions for the growth of import saving industries.

Paper XII

DEVALUATION—COTTON TEXTILE INDUSTRY PROSPECTS FOR EXPORTS

R. L. N. VIJAYANAGAR

THEORETICALLY DEVALUATION is a measure for promoting exports and discouraging imports. In practice, however, devaluation can promote exports only if the cost structure of our exporting industries is not vitiated and the international price structure for our goods remains unaffected.

So far as the cotton textile industry is concerned, it is observed that devaluation has affected the cost structure to the detriment of exports. Cotton which is the basic raw material of the industry and which accounts for nearly 50 per cent of the cost of manufacture of cloth has become dearer by about 15 per cent. On account of devaluation, the cost of imported cotton has increased by about 14 per cent to 32 per cent as could be seen from Table 1. (See p. 130)

Since the Indian cottons are in short supply, their prices have also increased by about 6 per cent to 30 per cent in sympathy with the rise in the prices of imported cotton following devaluation as could be seen from Table 2. (See p. 131)

In many cases, the prices of Indian cotton have pierced the ceilings prescribed by the Government. The rise in the total cost of manufacture on account of cotton alone is about 7½ per cent to 8 per cent.

Table 1

PRICES OF IMPORTED COTTON BEFORE AND AFTER DEVALUATION

(in rupees per candy)

Variety of cotton	Pre-devaluation price				Post-devaluation price				
	Landed cost	*Import duty*	*Premium paid to the ICMF*	*Total price*	*Landed cost*	*Import duty*	*Premium payable to the ICMF*	*Total price*	*Percentage increase*
Egyptian	2,300	266	760	3,326	3,623	36	200	3,859	16
Sudan	2,100	246	760	3,106	3,308	36	200	3,544	14
African	1,300	166	560	2,026	2,048	36	300	2,384	18
American 1-1/16" and above	1,350	171	120	1,641	2,126	36	—	2,162	32
American below 1-1/16"	1,200	156	120	1,476	1,890	36	—	1,926	30

As regards power and fuel, there has no doubt been no increase in the cost so far. Where mills are on oil firing as in the case of Bombay, the exact position of the rise in the prices of furnace oil which might take place cannot be predicted at the moment. However, it is observed that the prices of lubricants and other petroleum products have already gone up.

So far as dyes consumed by the industry are concerned, a sizeable quantity is being imported against the import entitlements earned under the cotton textile export incentive scheme either as finished dyes or as dyes intermediates to be converted into finished dyes by the indigenous dyes manufacturers for use by the industry. On account of devaluation, the prices of directly imported finished dyes have gone up by 57.5 per cent while the local dyes manufactured out of imported dyes intermediates have gone up by about 25 per cent to 30 per cent. As a result, the average increase in the prices of dyes consumed by the industry may be placed around 33 per cent. Similarly, the prices of other stores and chemicals have also gone up, and on a rough estimate, the rise in the cost of production of cotton textiles may be about 3 per cent on account of the rise in prices of dyes, chemicals and stores.

Table 2

PRICES OF INDIAN COTTON BEFORE AND AFTER DEVALUATION

(in rupees per candy)

Variety of Indian cotton	*Price prevailing prior to devaluation*	*Prices after devaluation*	*Ceiling price fixed by the Textile Commissioner*	*Percentage increase over the pre-devaluation prices*
ISC-67	2,100	2,200-2,400	not fixed	10
Nagar CO2	1,550	2,000-2,050	1,650	30
Laxmi	1,400	1,500-1,550	1,350	9
CO2 (Saurashtra)	1,550	1,650-1,700	1,430	9
Digvijay	1,410	1,475-1,500	1,410	6
197/3	1,140	1,200	1,140	6
Kalyan	1,100	1,150-75	1,100	6

Wages which account for nearly 25 per cent to 30 per cent of the total cost of manufacture of cotton textiles have also gone up considerably even before devaluation, due to phenomenal increase in the dearness allowance which occupies a preponderating position in the total pay packet of workers by virtue of its being linked to the point-to-point rise or fall in the cost of the living index. The quantum of dearness allowance which stood at Rs. 96.08 in 1963 steadily increased to Rs. 147.45 in May 1966. Since devaluation, the dearness allowance has further risen to Rs. 148.60 per month of 26 working days.

On account of devaluation, the prices of imported machinery have gone up and the prices of indigenous machinery will also go up because of imported components etc. As a result, the capital outlay increases and consequently depreciation and interest charges also go up. The increased working capital necessitated by the rise in the cost of manufacture would entail further borrowings involving additional interest charges.

In view of the rise in the prices of the various factors of production as explained above, the overall increase in the cost of production of cotton textiles may be placed around 15 per cent.

Prior to devaluation, the exports of cotton textiles were supported by incentives granted under the Cotton Textiles Export Incentive Scheme. Such incentives were partly in cash and were partly in the shape of import entitlements for dyes, chemicals and machinery. The scale of incentives prescribed under the Export Incentive Scheme was such that, by and large, it used to bridge the gap between the export price of the product and its cost of production. On an average, the export price realized for cotton textiles was about two-thirds of the cost and the export incentives were making up the balance. The export incentives, however, varied from market to market, the lowest and the highest being 30.55 per cent and 85.52 per cent respectively of the f.o.b. price of the goods exported. If, therefore, our cost of production remains constant, devaluation would provide the added impetus to our exports to those markets where the incentives receivable under the Export Incentive scheme were less than 57.5 per cent provided the prices for our goods in the international market remain at the pre-devaluation level. Conversely, if either our cost of production goes up or due to action of our competitiors by way of incentives or otherwise; the prices

payable for our goods in the international market suffer reduction, there will be a disequilibrium in our export trade calling for remedial action.

If, therefore, exports are to be sustained, the impact of devaluation on the cost structure of the industry should be cushioned. The important elements in the cost of production are cotton and wages. If economy could be effected in respect of these two elements, it could reasonably be hoped that exports could be maintained.

So far as cotton is concerned, it is our experience that while on the one hand the cotton grower complains that he is not getting prices attractive enough to keep him on cotton cultivation in preference to other cash crops, the industry finds that it is paying prices for cotton which are thoroughly out of parity with

Table 3

COTTON YIELD PER ACRE

Name of the country	*Yield per acre in lbs.* 1964-65	1965-66 *
United States	517	526
Mexico	591	638
Nicaragua	821	669
Guatemala	641	676
El Salvador	645	448
U.A.R.	665	—
Turkey	427	448
Syria	547	540
Iran	268	291
Israel	1063	1067
Greece	431	457
Spain	349	319
India	117	106
Pakistan	229	249
Sudan	302	307
Uganda	81	76
Tanzania	234	243
Argentina	228	179
Brazil	175	170
Peru	458	443
Columbia	362	398

* *Preliminary.*

world prices. This sorry state of affairs is entirely due to the yield per acre in the country being the lowest in the world with the exception of Uganda. Table 3 which gives the yield of cotton per acre in all the principal cotton growing countries of the world speaks for itself.

In view of the low yield per acre, the production cost is uneconomic and consequently, cotton prices cannot but be very high particularly as the supply falls short of the demand.

Table 4

STATEWISE YIELD PER ACRE OF COTTON

Name of the State	*Yield per acre in lbs.* 1963-64	1964-65
Andhra Pradesh	58	57
Assam	64	64
Bihar	358	168 (Nominal area)
Gujarat	122	132
Jammu and Kashmir	321	284 (Nominal area)
Kerala	161	183
Madhya Pradesh	86	89
Madras	153	162
Maharashtra	84	71
Mysore	59	57
Orissa	70	60
Punjab	268	272
Rajasthan	131	113
U.P.	71	112
Delhi	385	80 (Nominal area)
Himachal Pradesh	107	54 (Nominal area)
Tripura	145	153 (Nominal area)
Pondicherry	835	835 (Nominal area)

Table 4 gives the yield of cotton per acre Statewise in India. The Table shows that among the principal cotton growing States in the country, Punjab has the highest yield per acre being 268 lbs. in 1963-64 and 272 lbs. in 1964-65, while Mysore has the lowest yield being 59 lbs. in 1963-64 and 57 lbs. in 1964-65. Maharashtra which accounts for about 25 per cent to 30 per cent of all-India production of cotton has a per acre yield of only 84 lbs. in 1963-64 and 71 lbs. in 1964-65.

Table 5 shows the yield per acre of cotton of different varieties. (See Table on p. 136).

It will be seen from the Table 5 that Punjab Deshi, Punjab American, Madras Cambodia Uganda, Broach Vijay cottons give a production of 200 lbs. to 250 lbs. per acre, while Indo-American Strains, Madras Cambodia other than Uganda, Surti, I.S.C. 67 and Rajasthan Deshi yield between 125 lbs. to 175 lbs; Mysore Americans, U.P. Deshi, Kalyans, Karunganis and Comillas yield between 100 lbs. to 120 lbs., and the rest well below 100 lbs. per acre. The low yield of cotton per acre is, therefore, a serious problem and requires immediate remedial action. The industry has amply demonstrated by experiments carried out in the principal cotton growing areas that given proper technical know-how, the cotton cultivator can increase the yield per acre manifold and thus help himself in the shape of adequate return and also help the industry in the shape of reduced prices. The days of experiment are now bygone and the situation at present obtaining in the country demands that the modern technique of agricultural operations should pervade the entire country if we are to reap the fruits of devaluation. Production of cotton should be placed on warfooting, and Government should ensure that the modern technology of cotton production is enforced on the cotton cultivator through a special division of the Indian Army under the lead of a band of agricultural engineers specialized in cotton cultivation.

The Central and the State Governments should also enlist the support of the industry in their endeavours for boosting cotton production by making available to the industry a substantial portion of the proceeds of the 'cess' on cotton which has recently been raised from 25 paise to 75 paise per bale under the Produce Cess Act.

As regards imported cotton which at the moment is exerting

Table 5

YIELD PER ACRE OF DIFFERENT VARIETIES OF COTTON

	Description of cotton	*Yield per acre in lbs.* 1962-63	1963-64
1.	*Bengals*		
	U.P. Deshi	122	68
	Punjab Deshi	251	243
	Rajasthan Deshi	140	126
2.	*Americans*		
	Punjab American	234	259
	Buri American	65	78
	Madhya Pradesh American	86	89
	Indo-American Strains	167	176
	Madras Cambodia Uganda	207	192
	Madras Cambodia others	178	151
	Rajasthan American	98	111
	Parbhani American	58	84
	Laxmi	82	80
	Mysore American 5	116	114
3.	Sea-Islands (Andrews)	78	56
4.	Virnar (Incl. Jarilla)	80	86
5.	H-420	95	47
6.	*Oomras*		
	Maharashtra Oomras	61	62
	Hyderabad Oomras	56	84
	M.P. Oomras	46	65
7.	*Hyderabad Gaorani*		
	Gaorani 6 and 46	70	58
	Gaorani 12 and 22	64	56
8.	Malvi	46	72
9.	Broach Vijay	202	141
10.	Surti Vijalpa (Incl. Suyog)	167	124
11.	*Dholleras*		
	Saurashtra and Kutch	83	99
	Dholleras	121	108
	Kalyan	121	108
	Mathio (Incl. Pratap and Sanjay)	69	135
12.	*Southerns*		
	Jayadhar	72	71
	Kumpta Ordinary	37	36
	Westerns	75	65
	Mungari	89	103
	White and Red Northerns	98	98

	Description of cotton	Yield per acre in lbs. 1962-63	1963-64
	Chinnapathi (S. Staple)	60	60
	Karunganis (2 and 5 and Ordinary)	105	96
	Uppam, Nadam and Bourban	—	98
	Nandyal-14	77	60
13.	Comillas	101	88
14.	Other Deshi varieties	52	78
15.	I.S.C. 67	131	147

inflationary impact on Indian cotton by virtue of its being costlier due to the new parity of exchange rate, the Central Government should grant complete exemption from the import duty while the State Governments should provide suitable relief in sales-tax and octroi duties on all cotton, whether imported or indigenous.

Price control on cotton has turned out to be futile. Whenever the statistical position of indigenous cotton has been found to be difficult, the ceilings have always been pierced. On the other hand, when the supply position has been found to be easy and the prices are found to be ruling below the ceilings, there is always a clamour to secure the ceiling prices. In the interest of cotton cultivation, it is therefore desirable to abolish the floors and ceilings and instead to devise a scheme of support price with a thorough concentration on efforts as described above for increasing the cotton yield per acre with the resultant decrease in its production cost.

Economy in the wage cost should be effected by linking wages to productivity. In England, when the pound was devalued in 1949 due to exchange crisis, the late Sir Stafford Cripps, the then Chancellor of the Exchequer, firmly declared that

> especially and specifically there can, in our view, be no justification for any section of workers trying to recoup themselves for any increases in the cost of living due to the altered exchange rate.

Similar should be the attitude of our Government. The Central and the State Governments should render active assistance

in making the present wage system production-oriented so that any increase in wages is suitably compensated by increased productivity. In the total pay packet of industrial workers, it is observed that dearness allowane which is linked to point-to-point rise or fall in the cost of the living index is occupying a preponderating position which is not at all conducive to productivity. The vitiating influence of the dearness allowance should, therefore, be arrested well in time and the wage system made more attractive by built-in incentives to promote higher productivity.

As regards dyes, chemicals, stores, packing materials, etc. the rise in prices which has taken place as a result of devaluation should be neutralized to the extent possible by a suitable downward adjustment of customs duties, excise duties, sales-tax, octroi duties etc. as these commodity taxes being a substantial part of the prices have also been exerting inflationary pressure on the cost structure of the industry.

Apart from cushioning the impact of devaluation on the cost structure, the competitive ability of the industry should also be strengthened through modernization of plant and machinery. Though this problem has been the subject of constant discussion by various bodies right from 1952, nothing tangible has so far been done by the Government to render positive assistance to the textile mills in putting through schemes of modernization. The Working Party for the Cotton Textile Industry which submitted its report in 1952 recommended that high priority should be accorded to the rehabilitation of plant and equipment and to remodelling of some of the existing buildings of the industry. It also pointed out that the reserves available with the industry were not commensurate with the requirements of such a large task and that the Government should assist the industry by advancing loans at 4 per cent interest. The document entitled 'Programmes of Industrial Development, 1951-56' of the Planning Commission issued in 1952, made a reference to the recommendations of the Working Party and stated that the suggestion regarding financial assistance from the Government for rehabilitation and modernization was under consideration. In September 1954, the Lok Sabha resolved that rationalization of the textile and jute industries, wherever it was necessary, in the country's interests, must be encouraged and in

the Explanatory Memorandum to the Central Government Budget for the year 1956-57, it was stated that in view of the importance of the jute and cotton textile industry to the country's economy, Government had decided to grant loans for the rehabilitation and where necessary modernization of the plant and machinery in these two industries and that the National Industrial Development Corporation had been made responsible for handling the matter. The Memorandum also stated that the finances required by the Corporation would be provided by the Government. The Planning Commission's document entitled 'Programmes of Industrial Development, 1956-61" re-emphasized the need for the modernization of the cotton textile industry and pointed out that a survey unit organized by the Government of India was also engaged in getting factual data regarding the requirements of the mill industry for rehabilitation of equipment and machinery and that the National Industrial Development Corporation had been assigned the task of assisting financially rehabilitation programmes for which the investigations conducted by the survey unit would provide the necessary data. The Textile Enquiry Committee of 1958 while pointing out that a large majority of the machines in existence was installed more than 40 years ago and had outlived their usefulness, cautioned that

> if they are not replaced at an early date, its effect would be felt as it has been felt in the case of marginal and submarginal units, in the form of low production, bad quality of products, engagement of large number of workers and high cost of production.

The Working Group of the National Industrial Development Corporation which also went into the question of rehabilitation and modernization of textile mills stated in its report submitted in 1960 that

> there should be a minimum level of modernization in all units, a level below which no unit should be allowed to exist,

and pointed out that

> this level should be such that it should enable the mill to stand

on its feet without any further assistance from external sources and without causing undue hardship to workers.

The Working Group also made an eloquent reference to the scheme of modernization put into effect by the Government of the United Kingdom in the British cotton textile industry. Under the said scheme, the British Government played a predominant part in galvanizing the British cotton textile industry by spending as much as thirty million pounds. It is unfortunate that our Government is not as forward-looking as the Governments of other cotton textile producing countries of the world with the result that its textile policy has turned out to be most unrealistic and even inimical to the health of the industry.

The textile policy that was followed by the Government in the past was extremely inward-looking aimed at an all-out support for the capital light industry, namely, the domestic handlooms and the cottage powerlooms, notwithstanding the note of caution sounded by the Tentative Framework for the Second Five-Year Plan prepared jointly by the Economic Division of the Ministry of Finance and the Planning Commission to the effect that the emphasis on capital saving methods might well land us between two stools—the large-scale capital using methods might get discouraged without other methods filling in the gap with the result that we might have the worst of both the worlds. Such a policy brought into existence measures like the limitation of production by the organized sector of the industry, demarcation of the field of production, fiscal protection, grant of subsidies etc. Orders issued under the Essential Supplies (Temporary Powers) Act which was subsequently replaced by the Essential Commodities Act, were extensively used to interfere with the production of the organized mill industry. For instance, in November 1948, mills were compulsorily called upon to employ 75 per cent of their wide-width looms for the production of dhoties and sarees. In July 1949, the compulsion was slightly relaxed and in September of that year, it was withdrawn. It was again re-imposed in February 1950, when the mills were called upon to employ a minimum of 50 per cent of the wide-width looms for production of dhoties and sarees. In July 1951, the percentage was raised to 60 per cent though in October 1952, it was brought down to 40 per cent. Hardly with-

in two months thereafter, the mill industry was shocked to receive orders from the Government not to produce dhoties beyond 60 per cent of the production achieved in the 12-month period ending 31 March 1952. No explanation was forthcoming from the Government for such a drastic action but from the Report of the Kanungo Committee of Enquiry, it became known that the Government imposed the restriction on production of dhoties by the mill industry because the Government of Madras repeatedly requested the Central Government to reserve the production of dhoties entirely for the handloom industry. Apart from the restriction on the production of certain varieties of cloth by the mills, a 'cess' was imposed on the mill industry for the development of the handloom industry. In view of the inherent incapacity of the handloom industry to increase production according to the increasing needs, arbitrary restrictions imposed on production by the organized mill industry caused serious shortages of cloth for which the industry itself had to suffer the penalty in the shape of additional excise duties to inhibit consumption. The shortages that developed in the country from time to time by the inability of the handloom industry to increase production, however, came in as a direct invitation to powerloom industry to expand by leaps and bounds. According to the Kanungo Committee Report which was submitted in September 1954, there were only about 24,000 powerlooms working on cotton yarn. In less than a decade, it was discovered by the Government that there had come into existence 1,64,409 powerlooms good, bad and indifferent, notwithstanding the provision in the Control Order that no person should acquire or install any powerloom without the sanction of the Government. Of these 1,64,409 powerlooms, 71,965 looms were unauthorized as at the end of November 1963. It is needless to say that such a phenomenal growth was positively aided by substantial concessions in excise duties levied on powerloom cloth.

As a result of such a faulty textile policy followed by the Government, the textile industry is finding itself being fast disinterested from the vertical to horizontal units while the textile industry both in the United Kingdom and also in the European Economic Community has been undergoing a thorough structural adjustment in the vertical direction. The trend towards vertical integration in the UK industry will be pursued

with greater vigour in the event of Britain joining the E.E.C. As regards the European textile industry, the Commission of the E.E.C. has strongly recommended that (*i*) the textile industry must improve its competitive position through continued efforts in the modernization of its plant and machinery; (*ii*) the initiative taken so far towards greater concentration and integration should be pursued as in the opinion of the Commission, the establishment of a limited number of large combines would be sufficient to assure the place of the textile industries of the E.E.C. in the world market; (*iii*) intensification of research efforts must be considered as an important aim of the large combines; (*iv*) encouragement of further investment for the purpose of modernization should be made either directly through financial measures in the shape of special loans at low rate of interest or indirectly through fiscal measures in the shape of enhanced depreciation allowances; and (*v*) elimination of obsolete machinery should be encouraged by means of bonuses for scrapping. These measures of reorganization coupled with steps for increasing the productivity of labour would make the European and the British textile industries formidable competitors to India both in the European market as well as in their vast overseas territories. Besides the E.E.C. and Britain, there are several other competitors who have recently emerged strong enough to price out Indian textile goods from the West Asian, African and European markets and among them are China, Turkey, Egypt, Portugal, Spain and East European countries. Another potent factor to be reckoned with in the international market for textiles is the abundant production of man-made fibre fabrics. As supply of these fabrics is well above the demand, there is bound to be very severe competition in synthetic textiles which will have serious repercussion on international trade in cotton textiles. The Indian cotton mill industry, therefore, requires to be thoroughly galvanized through rehabilitation and modernization to produce qualitative cloth at competitive prices. The elimination of obsolete machinery should be encouraged by the grant of bonuses in the shape of Tax Credit Certificates for scrapping as a part and parcel of approved schemes of rehabilitation and modernization. Investment in modernization should be assisted by the grant of long-term loans by financial institutions like the Industrial Development

Bank, Industrial Finance Corporation etc. at low rates of interest as the profitability of the industry is not attractive enough to attract capital—equity or otherwise.

The measures listed above are, however, in the nature of long-term solution to the problem of exports. The immediate need is to arrest the fall in exports and to encourage development efforts. This calls for a steady export promotion policy on the part of the Central Government. In practice, it is, however, the experience of the industry that Government's policy on exports is rather vacillating. For instance, the Indian Cotton Mills' Federation which was charged with the responsibility of sustaining exports of cotton textiles through the disbursement of export incentives both in cash as well as in the shape of import entitlements, was discharging its obligation through levies on Indian and imported cotton. Though the Central Government originally committed itself to an annual import of 4.28 lakh bales for the purpose of providing the requisite resources to the Export promotion Fund of the Federation, Government could not adhere to their commitment during the last year while the liabilities cast on the Fund were increased due to enhancement of cash incentives. As a result, while in the initial period, the Export Promotion Fund of the Federation carried a surplus, today it is running into a deficit of several crores. Time is the essence of any export promotion measure but the failure of the Federation to disburse the incentives in time has caused a serious disruption of export efforts of mills. This could have been easily avoided by the grant of advances from the Market Development Fund by the Central Government, which could have been returned as and when the levies on foreign and Indian cotton were collected by the Federation to replenish its Export Promotion Fund. It is, therefore, urged that no uncertainties should be created to jeopardize the Herculean task of exports, and any export policy which is devised by the Government should not suffer from lack of either clarity or stability. Then and only then it is possible for the industry and the trade to make long-term plan for export.

In view of devaluation, the Central Government have abolished all the Export Promotion Schemes. So far as the cotton textiles export promotion scheme was concerned, the scale of incentives envisaged thereunder differs from market to market, and

as such in the case of hard markets like the West Europe, USA etc., the quantum of incentives granted was much more than the support rendered by devaluation. It is, therefore, imperative that in the case of markets where devaluation does not provide adequate incentive, there should be selective export promotion schemes providing for export incentives in the shape of Tax Credit Certificates and import entitlements for the import of scarce materials unless compensation by way of cash incentives is contemplated. These certificates should be granted for values worked out as a percentage of the export turnover at prescribed rates, irrespective of whether exports have been effected directly or through the exporters. The machinery to be devised for the issue of cash incentives or for the issue of certificates should be such that the mills and the merchant-exporters derive their incentives automatically as and when the exports take place in the same manner as the banks issue the certificates under the National Defence Remittance Scheme. The Tax Credit Certificates should be eligible for tax adjustment, if there are any tax dues or else they should be eligible for encashment. The import entitlement certificates should be eligible for free sale without any further let or hindrance to enable the exporting mill or the merchant to replenish his funds without any loss of time.

Since the scale of incentives for supporting export is determined with reference to the cost of production and the international price structure at a given point of time, nothing should be done to upset the cost of production by the imposition of taxes or duties on raw materials, stores, colours, chemicals, etc. used in the manufacture of goods for export. If revenue considerations demand the imposition of or increase in taxes or duties, there should be a simple scheme for the grant of consolidated drawback to neutralize the effect of customs duty, excise duty, salestax, octroi duty and electricity duty etc. The quantum of such drawback should be decided upon on the basis of the expert study of incidence of taxes on every commodity.

Exports of cotton textiles to Rupee Payment Countries like Russia, East European countries, namely, East Germany, Yugoslavia, Poland etc. require special attention. Though in respect of oustanding contracts, settlements have been reached with many of these countries for upward adjustment of prices on the basis of the new exchange rate, the prospects for export

development with them must need careful study. Our need for importing capital goods is great, and hence the necessity to maintain adequate export trade with these countries is imperative. Nothing should, therefore, be done to jeopardize our exports of cotton textiles to these countries. They should be maintained and even improved by bringing them within the scope of Export Incentive Scheme.

Exports to Afghanistan are on a special footing. Imports of dry fruits are allowed from Afghanistan in the first instance and the rupees accruing thereagainst are being utilized for export of cotton textiles. Contracts entered into prior to the date of devaluation were on the basis of incentives available under the Export Incentive Scheme. Such contracts which were outstanding on the date of devaluation, suffer heavy losses due to the abolition of Export Incentive Scheme. The Government should, therefore, not only see that the losses on these contracts are met, but should also announce its policy of exports to this country so that the mills and merchants can enter into forward commitments for export of cotton piecegoods and yarn.

Our Government should also take note of the likely development of large vertically integrated combines in the cotton textiles exporting countries like the U.K., countries of the E.E.C. and also their marketing practices and initiate suitable action to encourage vertical formations in our industry and also the establishment of trade contacts for a systematic development of our export markets. The industry should be freed from the shackles of control to enable it to adjust its production programme after taking into account its external and internal trade into account. In view of the complexity of the overseas markets, regular and continuous market research should be instituted to grasp the tastes and fashions of each individual market. There should also be vigorous publicity of Indian textiles in the overseas markets. For this purpose, suitable grants should be made to the industry from the Market Development Fund. To maintain and improve the quality of cotton textiles exported, pre-inspection at the mills and subsequent inspection at the hands of the quality control authorities should be increasingly resorted to. Wherever necessary, suitable training should be imparted to operatives handling export varieties of cloth.

If short-term measures as described above are announced by

the Government without any further loss of time and they are followed by long-term measures referred to earlier in this paper, there is no reason why we should not be in a position not only to keep up our export trade in cotton textiles but also improve it further in the wake of devaluation.

Paper XIII

DEVALUATION AND EXPORTS OF ENGINEERING GOODS

B. V. BHOOTA

THE GOVERNMENT OF INDIA have devalued the rupee twice after Independence, first in September 1949, coincidental with the devaluation of £-Sterling and second on 6 June 1966 on the grounds that this measure will help to boost our exports and also solve the problem of payment difficulties. Even since the Bell Mission of the World Bank had submitted its report, the discussion on devaluation has been going on. Now that devaluation is a *fait accompli* all we can and should do is to see how we can keep up the rising trend of Engineering Exports. As a matter of fact, to earn the same foreign exchange, we have to increase the value of exports by 57.5 per cent.

Prior to devaluation, i.e. 6 June 1966, exports of engineering goods were rising steadily. This is evident from the following figures:

	(*Rs. lakhs*)
1960-61	847
1962-63	984
1963-64	1,464
1964-65	1,963
1965-66	2,300

Export of engineering goods in 1955-56 was Rs. 4-5 crores, and in 1965-66 it went up to Rs. 23 crores, thereby recording nearly 500 per cent increase. At present, we are exporting nearly 150 items to more than 100 destinations. We are exporting not only to the countries in Asia and Africa, but also to highly industrialized countries like Germany, USA and UK. Market surveys conducted by the Engineering Export Promotion Council have revealed that these highly industrialized countries could be our largest buyers for simple manufactures and also for semi-finished components for their complicated machines. As time goes by we should also be able to sell highly sophisticated capital equipment, not only to developing but also to some of the East European countries.

The current production of engineering goods, which is estimated to be at Rs. 1,000 crores, is likely to go up to Rs. 1,400 crores by 1970-71. We had accordingly fixed a target of Rs. 42 crores for 1966-67. Considering the performance in 1965-66, we were confident that we would be able to achieve this target. We were also contemplating, and in fact, had submitted our suggestions for achieving a target of Rs. 100 crores by the end of the Fourth Five-Year Plan. All these proposals were prior to devaluation and we have to see whether and how the engineering industry would be in a position to achieve these targets in the changed circumstances.

With effect from 6 June 1966, the Government have abolished all Export Promotion Schemes. The engineering industry in India is dependent on many imported raw materials and components. The impact of devaluation on engineering industries, especially those which are manufacturing their products predominantly out of imported raw materials, will be severe inasmuch as rupee cost of imported raw materials, components and spares would go up by 57.5 per cent. A substantial percentage of export of engineering goods contained items with import contents ranging from 20 per cent to 50 per cent on an average. Plants which are established under deferred payment arrangements would have to find more rupees to meet their obligations. To sum up, cost of production would go up not only because of direct increase on imported materials, but also owing to the incidence of rise in cost of other materials which are used by the industry. Thus the full benefit of 57.5 per cent is not available

to the engineering industry. It should, however, be recognized that if our half-utilized engineering capacity is put to full use consequent to easy availability of raw materials and components and thus can have increased turnover we can expect some reduction in costs.

Our engineering goods have been facing keen competition from some of the highly industrialized countries like Japan, UK, Germany, etc. We were able to build up sizeable exports only by competing with these giant exporting countries by offering our products at the same or rather at somewhat lower prices than what these countries were offering to overseas buyers. The quality of engineering goods had to be maintained up to the international product. These made us, on the whole, to sell our goods at about half the Indian price in many cases. Because of low productivity, underutilization of plant capacity and many other inhibiting factors, the cost of production has been high. The Government recognized the fact that Indian exporters were incurring losses on their exports, and accordingly had given a number of direct and indirect subsidies to the exporters, which were in the shape of supply of raw materials at international prices, refund of customs, and central excise duties, import entitlement and cash subsidy. The most important facility which the exporter was enjoying was the import entitlement by which he was able to recover his losses substantially by producing more through the help of imported components and materials. Other facilities also helped the exporter in meeting his losses.

Devaluation should help the Indian exporters and they should be in a position to offer their products more competitively. There is no doubt that exporters have been benefited to the tune of 57.5 per cent, but this advantage in the rupee value of export earnings would, to a great extent, be offset by the increased cost of inputs, increased shipping freight and consumer resisttance abroad. Devaluation might help the traditional items like tea, jute, etc. but, for engineering industries, on the whole, besides the benefit due to devaluation, some additional assisance will be needed in place of the Export Promotion Scheme which has been abolished.

Export of engineering goods during March 1966 was Rs. 2.70 crores, the highest on record for a single month. We, therefore,

hope that the Government would make an announcement of the alternative schemes, which can keep up the tempo. The engineering industries are very eager to help the country by exports to the maximum extent possible. Some of them may even be willing to bear some sacrifice in exports compared to internal sales. We have to find a solution that is universally applicable. The major problem in the engineering industry would be that there are too many exporters and variations in products and thus a time may come when, unless some definite inducement is given to exporters, the exports may suffer as others, who are not exporting, may establish themselves in the internal market. A kind of levy on those who are selling in the internal market is not generally feasible. How best this situation can be handled is for the exporters to decide and suggest.

The Government have declared their intention to liberalize 59 industries, out of which 33 are engineering industries. These industries have been assured the supply of imported raw materials and components for running the industries to their full capacity. However, as Mr Tata has rightly remarked, we cannot and should not depend upon non-project aid to continue for ever, and thus it is conceivable that in time to come, we may have to restrict the imports to some extent. Some estimates made of import requirements to run the engineering industries to full capacity indicate import requirements of as much as $ 878 million—a figure which indicates that liberalization may not be extensive or lasting. Imports also will have to be confined to countries giving non-project aid and thus the importer would have to buy from a particularly assigned country. While the liberalization is good for the industries, there are or there will be some restrictions from which the exporting industries should be free. It is thus our suggestion that the exporting engineering industries should be given some import licences which should cover the components and raw materials necessary for exports from any country and also which should allow them to modernize their plant and equipment to be more competitive. To make for a simple scheme, this should be a certain percentage of the f.o.b. value. Devaluation does not neutralize all the excess costs in India and thus it would still be necessary that the old concessional rates of steel and pig iron and benefits arising out of drawback, with suitable adjustments, as and when chan-

ges in the Excise and Import Duty are announced, should also be automatically continued. The import entitlements given to the engineering industries for replacement would enable them to buy from any country of their choice and from the cheapest and best sources in the world. In order that no misuse occurs, it can be specified that only the imports of items allowed to be imported in the Red Book would be allowed and the exporting industry should certify that such imports will be used for only essential and notified industries by themselves or by those to whom they have sold since one transfer is recommended to be allowed. The Export Promotion Council can be a watch-dog in this regard and make sure that no misuse occurs. It should also be appreciated that, as the country industrializes and the engineering industries become more sophisticated, there will be lot of sub-letting by bigger units to smaller units which also indicate the necessity of transfer from one unit to the other.

The best and most effective stimulant for exports should be by way of financial incentives. The Tax Credit Scheme should be extended to all types of engineering goods and every exporter must get some kind of tax incentive.

Also, in order to induce the foreign collaborator to allow the export of goods made in India with his collaboration some tax concessions need to be devised. If the foreign collaborator allows the sale of the components and/or machines for use in his own factory or in his associate companies or collaborator's factory or to others, and thus for payment of foreign exchange flows out of the country, the royalty should be exempted from Indian income-tax or get special tax concession. In short, the tax policy should be oriented to help those collaborators who allow the sale of Indian made goods to earn foreign exchange.

A study of exports of engineering goods of Japan—a country we can well emulate—has shown that in the year 1964, the value of exports were of the order of US $2,896,000,000. Of this, $ 2,223,129 or 77 per cent accounted for General, Electric and Transportation equipment. A good portion of this is 'turnkey jobs' some of which we have bought from Japan. As time goes by, it is possible that we should be able to increase our exports and it would not be suprising if, percentage-wise, as India industrializes, our exports will not be of the same type as those of Japan.

This indicates that we will have to develop first necessary design and manufacturing facilities for undertaking such equipment and 'turnkey projects' in India and that such firms should be able to mobilize their resources by forming out their work to various sub-contractors—which again indicates the necessity of at least one transfer—of course at the same making sure that the imports are used for the specific essential industries.

Summarizing it can be mentioned that in order to continue the past exports and also to boost them up, certain definite measures are necessary in the new Export Policy:

1. Pre-devaluation concessional prices of steel and pig iron to be continued.
2. The benefits of drawback for Excise and Import duty to be continued.
3. Certain Import Licences to the extent of imported contents in the exports, with one transfer, to be given with the express provision that these are to be utilized for essential industries. This can be a certain percentage of the export value.
4. Where devaluation does not fully cover the difference between the export and Indian price, tax credit certificates should be given to the exporter. Tax reduction or remission are to be given to the foreign collaborator who allowed exports to pay royalties.

THE IMPACT OF DEVALUATION AND CONSEQUENTIAL DECISIONS ON EXPORT OF ENGINEERING GOODS

R. K. SINGH

DEVALUATION IS NOW an accomplished fact. It will be fruitless exercise to go into the theoretical discussions of its merits and demerits. I, therefore, propose to discuss in the following paragraphs, impact of devaluation and certain consequential decisions or lack of decisions on export of engineering goods.

Export of engineering goods in the course of the last few years has been built up with the assistance available to exporters in the form of:

(*a*) concessional prices for steel and pig iron,

(*b*) drawback of duty,

(*c*) import licence based on specified percentage of the f.o.b. value of exports, and

(*d*) cash subsidy in selected items.

The schemes introduced sometime in 1958-59 passed through several stages of growth. It was only in the course of the last two years that full impact of these benefits came to be reflect-

ed in the export. During the financial year ending March 1966, exports reached an all time record of Rs. 25 crores which, when compared with the performance in 1958-59, represents an increase of more than 800 per cent. Performance has been creditable both in respect of coverage of new items and new territories. Through the sustained efforts of the Engineering Export Promotion Council, both inside and outside India, an image was created about the ability of Indian Engineering Industry to meet the requirements of overseas markets. One of the most remarkable developments which has taken place during the last two years is the growth of confidence in Indian industry to compete both in respect of quality and price, and a similar confidence in overseas buyers, especially from the highly developed countries of the West, in India's ability to meet their exacting requirements. It was with this confidence that a target of Rs. 42 crores, including steel and Rs. 32 crores excluding Steel was fixed for the financial year 1966-67. Export performance for the month of March 1966 reached an all time record of Rs. 270 lakhs, a figure which was equivalent to the whole year's export when the export assistance schemes started. The moment export really got into its strides and it was hoped that the tempo will get accelerated in future years, the announcement was made for withdrawal of export incentive schemes consequent upon devaluation. Even after six weeks of devaluation, there has been no announcement of alternative scheme. The result of this indecision has been disastrous. The position may be summarized as under:

(*i*) Immediately after announcement of withdrawing export assistance schemes, many of the exporters stopped their despatches, with the result that shipments after 5 June 1966 are hardly 25 per cent of the normal monthly shipments which could have been of the order of Rs. 3 crores in the first half of the current year.

(*ii*) In the absence of an alternative scheme providing a packet of assistance to exporters equivalent to the assistance available prior to devaluation, almost all the negotiations for future business have been suspended. Due dates for many tenders have lapsed without our exporters participating in the tenders. At the moment of writ-

ing, business of nearly Rs. 6 crores, reported to the writer, was allowed to slip out of hands because of uncertainty about the future policy. This is naturally going to have an adverse effect on the future exports.

(*iii*) A substantial percentage of export of engineering goods is contributed by items with import content ranging from 20 per cent to 50 per cent on an average. In such cases, the dearer cost of imported raw materials would substantially mop up the gains of 57.5 per cent in rupee value as a result of devaluation.

(*iv*) While a substantial portion of devaluation again would be eaten up by import of raw materials, overseas buyers from all over the world have started putting serious pressure on Indian exporters to reduce the prices of exported products, although this expectation on the part of buyers is unreasonable because if our quotations in sterling and dollar were competitive prior to devaluation, they should be competitive after devaluation also. As things stand, it would be extremely difficult on the part of Indian exporters to resist, for long, pressure from overseas buyers, and they will have to give at least some reduction in prices which would reduce the foreign exchange earning. The only significant business after devaluation, which was reported to the writer by an exporter of electric fans, was to the tune of Rs. 12 lakhs on which a 5 per cent reduction had to be agreed to because if the price had not been reduced, the business would have gone to another competitor. This has meant a loss of Rs. 60,000 to the country and a further loss to the exporter which, in the normal course, might have been earned by transfer of entitlement. Exporters throughout the country have, of course, received similar demands from their buyers.

(*v*) There are certain commitments which were entered into prior to 5 June 1966, but since exporters have been told that export promotion schemes existing on 5 June would not apply to exporters after that date, exporters would have either to export and face financial ruin, in case al-

ternative scheme as and when announced, is not of the same order as on the date of commitments, or there will be breach of commitments resulting in endless disputes and drain on foreign exchange by way of settlement of claims.

(*vi*) One of the facilities available to exporters has been the supply of steel, pig iron at L.M.E. prices which have been lower than the normal J.P.C. prices in India The facility has been suspended, with the result that contracts amounting to roughly Rs. 6 crores already entered into on the basis of concessional steel pig iron prices for important items like wagons, railway track materials, castings, etc., are in jeopardy. Dislocation in the delivery schedules would seriously affect future business.

It has, therefore, become imperative that alternative scheme of export assistance is announced as early as possible. The industry is grateful to the Ministry of Commerce for the sympathetic consideration which they have given to the problems arising out of devaluation and withdrawal of export assistance scheme and the efforts which they are making towards formulation of an alternative scheme. The industry owes a special debt of gratitude to the Commerce Minister for his untiring efforts in getting over the difficulties which exporters in general are experiencing. The agreement reached with the USSR and other East European countries, whereby prices of Indian exports could be raised by 47.5 per cent in the case of the USSR and 57.5 per cent in the case of some Eastern countries, is most satisfactory and it is hoped that he will achieve similar success in solving the problems of engineering industry which has been most seriously affected after devaluation.

A recent study made in connection with certain selected items representing nearly 75 per cent of the total export of engineering goods has shown that there is substantial loss in export in relation to the f.o.b. realization on sales abroad even after taking into account the gain of devaluation.

The extent of loss can be seen from the following figures:

Item	Unit	F.o.b. cost (Rs.)	F.o.b. realization plus benefits of drawback and steel concessions etc.	Loss in relation to f.o.b. cost (Rs.)	Percentage of loss in relation to f.o.b. realization
1. *Steel pipe*					
(*a*) Galvanized	1 m/t	1,782.03	1,440.73	341.30	35
(*b*) Ungalvanized	1 m/t	1,408.99	1,255.23	153.76	19
2. *C.I. products*					
(*a*) Cast iron pipes	1 m/t	907.87	687.00	220.87	40
(*b*) Cast iron pipe fittings	1 m/t	1,072.87	742.00	330.87	54
3. Electric fans (ceiling)	1 no.	167.63	100.50	67.13	70
4. Bicycles	1 no.	237.80	123.80	114.00	104
5. Sewing machines	1 no.	97.70	72.35	25.35	35
6. Storage batteries	1 no.	200.48	94.60	105.88	115
7. Railway track materials. (screw spikes)	1 m/t	1,985.00	1,550.00	435.00	38
8. Twist drills	1 doz.	94.75	46.00	48.75	119
9. M.S. ghamellas	1 m/t	2,848.50	2,231.00	617.50	41
10. Drop forged hand tools	1 m/t	13,150.00	9,850.00	3,300.00	35
11. *Wire ropes*					
(*a*) Galvanized	1 m/t	7,750.00	3,071.00	4,684.00	192
(*b*) Ungalvanized	1 m/t	6,115.00	2,500.00	3,915.00	204
12. Steel furniture tubular folding type	1 m/t	3,500.00	2,731.00	769.00	35
13. Bright steel shafting	1 m/t	1,394.00	1,045.50	348.50	51
14. Non-ferrous alloys	1 m/t	15,000.00	8,000.00	5,500.00	72
15. Aluminium-ware	1 kg	15.46	9.32	6.14	66
16. Aluminium conductor	1 m/t	8,200.00	4,565.62	3,634.38	95
17. P.V.C. aluminium cable	1,000 yds.	720.00	335.16	384.84	120
18. Aluminium Foils	1 kg.	32.24	13.40	18.84	140

	Item	Unit	F.o.b. cost (Rs.)	F.o.b. realization plus benefits of drawback and steel concessions etc.	Loss in relation to f.o.b. cost (Rs.)	Percentage of loss in relation to f.o.b. realization
19.	Non-ferrous locks	—	4,335.00	2,100.00	2,235.00	106
20.	Dry batteries	1,000 pcs.	1,205.63	524.60	681.03	144
21.	Torches	1,000 pcs.	1,758.07	1,030.07	728.00	79
22.	Automobiles (complete bus)	1 no.	64,579.00	52,375.00	12,204.00	26
23.	P. & H shovel	1 no.	5,60,630.00	3,63,530.00	1,97,100.00	56
24.	Transmission line towers	1 m/t	2,021.00	1,540.00	481.00	42
25.	Vertical turbine pumps	1 no.	7,920.00	5,346.00	2,574.00	51
26.	Diesel Engines	1 no. (5 hp.)	2,252.00	1,747.00	505.00	31
27.	Rubber insulated copper conductor	1,000 yds.	27.30	15.80	11.50	82

The above calculations have been made assuming that exporters would continue to enjoy facility regarding concessional prices of steel and pig iron. In case it is decided to discontinue the facility regarding concessional prices, the extent of loss would be still higher.

Having regard to the vast potential of the engineering industry and keeping in view the fact that there is a demand for a wide range of fabricated engineering products both in the developing as well as developed countries in the West, it is imperative that exporters of engineering products are provided with a packet of assistance which places them at least on par with the conditions at the time of devaluation. Even the developed countries, who have years of experience and goodwill established for their fabricated products, have offered assistance and continue to offer assistance of one kind or the other to step up exports of fabricated engineering products. These countries have established specialized institutions which provide most

up-to-date banking insurance, market survey and research facilities. They have their own shipping which offers a unique advantage to the exporters both in the matter of availability of space and rate of freight. They offer relief in income-tax. Some of the countries had also given cash assistance (for instance Italy has been giving cash assistance to promote export of various products). Even though price and distribution of steel is not controlled, the organizations concerned have voluntarily come forward to offer special concession in steel prices. For instance, ship-building industry in one of the West European countries has recently been given 10 per cent reduction in steel prices. It is unfortunate that in India export assistance given to exporters has always been viewed with suspicion and disfavour in certain circles. Some of the people in responsible positions seem to be prejudiced to the extent that they consider that the economic ills of the country are mostly due to incentive schemes.

I am strongly of the opinion that in the initial stages of development, incentive schemes play an important part in boosting up exports. A study of the growth of export, especially of fabricated products all over the world, would establish beyond any shadow of doubt that assistance of one kind or the other has been given in the initial stages. As and when conditions have improved, the nature and quantum of assistance has been changed. It is in this background that exporters of engineering goods should continue to receive assistance at least for the next ten years. The assistance should be somewhat on the following lines:

(*i*) Exporters should continue to get supplies of steel/pig iron at prices prevailing prior to devaluation. Besides size, section and quality extras should not be higher than the extras charged to our competitors abroad;

(*ii*) They should continue to get refund of excise and import duty;

(*iii*) Even if there is liberalization in import, they should be given free foreign exchange related to a percentage of the f.o.b. value earned, so that they are free to import raw materials, stores, balancing equipment for improve-

ment of quality or for diversification of products for export.

(*iv*) In addition, where exporters still suffer losses in relation to fair f.o.b. cost in India, they should be given cash assistance, quantum of which can be determined from time to time depending upon the extent of loss.

A policy announcement should be made assuring exporters continuance of above assistance schemes for a period of five years after which the position could be reviewed. Because of frequent changes in the scheme and its ultimate withdrawal disregarding commitments entered into, the confidence of exporters has been shaken. They are not in a position to enter into any long-term commitment. It is necessary, therefore, that confidence is restored in them so that they organize export effort without any fear.

Paper XV

DEVALUATION AND NON-TRADITIONAL EXPORTS WITH REFERENCE TO LIGHT ENGINEERING INDUSTRY

R. D. VIDYARTHI

Introduction

WITH THE ACHIEVEMENT of freedom, India's urge to exploit her vast potential resources and to set up new industries received a fresh stimulus which, during the last 15 years, has enabled Indian engineering industries to develop at a very fast pace. Today everything from a pin to a ship is being manufactured. In the field of consumer goods industries, a large variety of items like electric fans, lamps, batteries, radios, bicycles, hurricane lanterns, sewing machines, safety razor blades, buckets and sheet metalware, etc. are being manufactured. A host of producer goods like diesel engines, electric motors, transformers, ball-bearing, beltings, coated abrasives, etc. are being turned out. Great progress has been made in the field of capital goods industries too. As a result of all these developments, today the total production of engineering goods stands at about Rs. 1,250 crores per year.

Export Markets

With the progress made, Indian engineering industries have entered export trade in as many as 120 different engineering items to about 100 countries of the world. India has entered almost all the markets in South East Asia, East Africa, West Africa, West Asia. In a number of items she has gone far afield in markets of highly industrialized countries as USA UK, South America, Australia and New Zealand.

The following Table indicates the export of light engineering products during 1965-66:

(*i*) *Mechanical :*
Diesel engines, hand tools and small tools, data processing machines, sewing machines, pumps, agricultural machinery.
Rs. 292 lakhs.

(*ii*) *Electrical :*
Fans, batteries, electrical accessories, radios, electric motors, transformers, etc. lamps, air-conditioners, refrigerators, flashlights.
Rs. 287 lakhs.

(*iii*) *Consumer items like :*
Bicycles, aluminium utensils, builders' hardware, steel furniture, steel trunks, umbrellas and fittings, gramophone records, stainless steel utensils, oil lamps and stoves, EPNS ware, crown corks, razor blades, brass and copper utensils, containers and closures, wire and wire products, water fittings, cutlery, G.I. buckets, woodscrews, ghamelas, enamelware.
Rs. 492 lakhs.

The total export of engineering goods during 1965-66 is of the order of Rs. 19 crores. Thus it would be observed that the export of light engineering products constitutes about 60 per cent of the total export trade in engineering goods.

This export trade in engineering goods has been possible firstly through the crusading spirit of a few enthusiastic industrialists and more importantly through the special export promotion scheme which enabled exporters to recoup a part of their losses

on exports which have been rising owing to higher cost of production.

High Cost of Production

The economic studies in the cost structure of engineering industries indicate that the increase in the value of raw materials, chemicals, fuels, lubricants and electricity consumed has increased at a very fast rate in India. Between 1951 and 1965, input as percentage of output has increased from about 58 per cent to 75 per cent. The reasons for this state are twofold: firstly, the raw material prices have been rising continuously and secondly, emoluments to labour have consistently increased without proportionate increase in the productivity of labour. The prices of steel materials during the span of one year have risen by about Rs. 100. Pig iron price which stood at Rs. 276 in February 1964 rose to Rs. 368 per tonne in August 1965. Since 1956, those rises have been very high indeed. Wages to labour have not only risen but the unfortunate fact is that there has been no proportionate rise in productivity. On account of the rise in the cost of production the profitability of the industry has tended to decline. There is no better index of industrial efficiency in an idustry than the falling ratio of input to output. This, however, has not been possible in the case of India.

Effects of Devaluation on Costs

With these inherent weaknesses in the economy of the industry, the devaluation of rupee has further added to the rise in production cost in varying proportions as shown below:

	Percentage rise
Machinery	38.5
Primary raw materials	33.8
Intermediates and other raw materials	38.9

So far as non-ferrous metals are concerned the price rise would be as under:

(*per tonne*)

Material	*Before Devaluation (in Rs.)*	*After Devaluation (in Rs.)*
Copper	11,400.00	15,800.00
Zinc	2,125.00	2,800.00
Lead	2,000.00	2,675.00
Tin	25,200.00	34,000.00

The basic raw materials for the engineering industry are iron and steel and non-ferrous metals. Currently the country's import of steel is worth about Rs. 108 crores per annum and of non-ferrous metals worth about Rs. 70 crores. Besides the burden of the import duty, there is countervailing Central excise on these materials. As a result of these factors the import cost of these materials would rise.

It is estimated that owing to devaluation the rise in the cost of some of the indigenous items is likely to be of the following order:

	Per cent
Industrial plant and machinery	8 to 20
Steel wire ropes	21
Transformers	30
House service meters	15
Valves	20
Bicycles	15
Components	57.5

These are going to have adverse repercussions on the cost of production of the light engineering goods both directly as well as indirectly.

Future of Export Promotion

While devaluation has thus released forces which would push up cost of production, it has not conferred any benefit on the export trade of the country. The export trade has, on the other hand, received a rude shock as a result of devaluation of the rupee. Conservative economic thinking holds the view that devaluation of currency should give a boost to the export trade

of the country, as in terms of home currency, the exporter is enabled to earn more money than would be the case otherwise. There are, however, two important factors underlying these assumptions: firstly, the production of goods and services should have reached a high level so that goods may be offered off the shelf, so to say, and secondly, the cost of production should be such as would enable the country to offer goods at competitive rates in the world markets. Unfortunately in the case of India none of these two conditions are present. Production is, by and large, consumed at home and even if there were surpluses they are not competitive in world markets owing to higher cost of production.

Following the devaluation of the rupee export promotion schemes have been withdrawn in the hope that the increase in the value of the foreign currency to the extent of 57.5 per cent would compensate adequately for the losses in export trade. However, as a result of increased cost of production and the expectation abroad of lower prices of Indian merchandise owing to devaluation, this advantage would, to a large extent, be nullified.

The export of engineering goods, as has been stated above, has been possible only by Indian exporters offering quite low prices in foreign markets which have no relationship with the cost of production and which are substantially below internal prices. In the scheme of things Government had permitted varying import entitlements to exporters which enabled them to meet their losses. The withdrawal of the export promotion schemes has put the Indian exporters in a difficult position. The extent of loss even after taking into consideration the benefit of devaluation is indicated in the following Table groupwise:

(in per cent)

Rate of Entitlement	*Earnings from transfer of entitlement at 180%*	*Earnings from devaluation of Indian rupee*	*Loss*
40	76	57½	18.5
50	95	57½	37.5
60	114	57½	56.5
75	142.5	57½	85
90	170	57½	113.3

This loss will be further increased owing to rise in cost of production.

Measures Necessary for the Future

The measures that are now necessary fall into two groups: first group relates to short-term measures regarding the reinstitution of the export promotion measures and the second group comprises medium-term measures which would help in lowering cost of production.

Without any further loss of time Government should announce the fresh export promotion measures which should *inter alia* include drawback of excise and customs duty, concessional prices of iron and steel and reduced railway freight. A new basis for making up the loss and to place the exporter in a position obtaining prior to devaluation should be worked out keeping in view the loss on exports of individual commodities. At the same time, it is also necessary to devise ways and means of ensuring that commitments made up to 6 June 1966 are honoured.

In the ultimate analysis, however, success will depend only on lowering the cost of production which would make Indian engineering goods competitive abroad. International trade is based on the theory of comparative cost. Unless India can achieve the advantage of lower cost of production and be competitive, her export trade is bound to suffer. The objective of larger exports cannot be realized in the face of increasing prices and rising production costs. Over the years, as has been shown above, the price of basic raw materials and wages have been rising. It is, therefore, very necessary that the question of reducing import duties on raw materials and essential stores should be seriously considered. A nominal duty of 5 per cent may be levied, at least for the period of the Fourth Plan. On pig iron there is an excise duty of Rs. 40 per tonne. On steel there is an excise duty on an average of about Rs. 160 per tonne. Similarly on non-ferrous metals there are excise duties and countervailing duties. These should be abolished. Similarly emoluments to labour must be related to productivity and managers of industry should be enabled to enforce strict discipline to achieve production targets. For this purpose labour policy should be modified wherever necessary. These adjustments alone would

enable the country to build up a flourishing export trade in engineering goods.

Conclusion

We have surveyed generaly the effects of devaluation on the cost of production and the export trade of engineering goods. We have observed that the situation is quite grim. Burdens can be lightened only by bold and determined measures which entirely lie in the hands of the Government.

At present total exports of engineering goods constitute hardly 2 per cent of India's production and only about 3 per cent of the import bill of the engineering industries. It is obvious that larger exports have to take place in order to pay for the import needs of the industry and the country. Markets so far developed are in the developing countries which themselves have problems of development. It is, therefore, necessary that these markets are sustained and export trade developed on an extensive scale. The target before the country should be that engineering goods, by and large, form a significant share of India's exports and eventually of world trade. This is possible and can be achieved with the execution of largescale development programmes before the industry provided there is simultaneously a crusade against increasing prices and rising production costs. Devaluation has thrown up a new challenge to Indian engineering industry. It must be met at all costs. In this task the role to be played by the Government is crucial and important.

Paper XVI

DEVALUATION AND THE PROSPECTS OF EXPORTS OF NON-TRADITIONAL ITEMS TO COUNTRIES IN ASIA AND AFRICA *

RAM GOPAL AGRAWAL

THE RUPEE has been devalued and, it must be accepted as a settled fact. Export promotion has been given out to be one of the major objectives of this drastic decision. The Finance Minister himself stated in his special broadcast to the nation on 5 June 1966 that one of the reasons for bringing about devaluation has been to devise 'a more enduring and reliable way of restoring and, indeed, increasing the competitive power of our exports'. The success or otherwise of devaluation as an instrument for boosting our exports has to be seen. It can be stated that the expansion of our export trade will depend ultimately on the availability of surpluses in our agricultural, mineral and industrial sectors and the competitive capacity of our commodities in the international markets.

Review of Export Effort

India has been making concerted efforts, particularly during the last three Five-Year Plans, for the expansion of our exports,

* The views expressed do not necessarily reflect those of the FICCI.

both quantitatively and qualitatively. Emphasis has also been placed on the diversification of our export trade. Exports, which stood at Rs. 679.69 crores during 1961-62 in the first year of the Third Plan, rose to Rs 809.55 crores in 1965-66. It is estimated that we have been able to achieve an increase of 20-25 per cent in our exports during the Third plan period over the previous Plan. Several factors contributed to the increase in exports during the Third Plan, such as the real increase in the quantum of exports, rise in the unit value of several items, diversified commodity composition and a wider destinational pattern. The country had also fixed an export target of Rs. 5,100 crores for the Fourth Plan period, reaching an estimated figure of Rs. 1,100 crores by 1970-71. (These figures relate to the pre-devaluation rupee. The new targets, taking into account the 57.5 per cent increase plus other increases that may take place, are being worked out by the Planning Commission and the Ministry of Commerce.)

Composition of Exports—
Traditional and Non-Traditional

Though India has made rapid strides during the successive Five-Year Plans and the image of India as an agricultural and raw material producing country is gradually being replaced by that of an industrial nation, nearly three-fourths of our exports still consist of agricultural and plantation products and manufactured goods made out of agricultural raw materials like raw jute, sugarcane, oilseeds, etc. The various commodities that enter into our export trade are often classified into two groups, viz: 'traditional' and 'non-traditional'. The traditional items of our exports consist mainly of tea, jute, cotton textiles, vegetable oils and oilseeds, leather and leather goods, handlooms and handicrafts, spices, etc. On the other hand, the non-traditional items, which are comparatively new in our export trade, include various engineering goods (such as diesel engines, electric fans and sewing machines, bicycles, steel pipes and tubes, steel castings, aluminium utensils, railway track materials), and items such as dyes and colours, pharmaceuticals and drugs, paper and paper products, chemicals and allied products, silk fabrics, etc. However, the dividing line between these two groups of

commodities is not often quite distinctive, nor can there be any hard and fast rule to classify them. A major characteristic of our traditional items is that they have been moving out without any special export incentives. However, to cite an example, cotton textiles, which is one of our major traditional items of exports, needs various forms of assistance like many non-traditional items. It is known that, even after devaluation, some form of assistance is necessary to keep up our exports of cotton piecegoods. To cite another example, iron ore, which can be considered as a non-traditional item in view of its late entry into our export trade, has moved without any assistance worth mentioning. Oil-cakes also fall in a similar category.

Our Export Structure

Before going into the question of the likely impact of devaluation on our future exports, it may be worth while analysing briefly the structure of our exports during the period immediately prior to devaluation. Export during 1965-66 at Rs. 809.55 crores showed a decline by about Rs. 6 crores as compared to the exports in 1964-65 which stood at Rs. 816.30 crores. This decline has been mainly attributed to the failure of monsoon and severe drought conditions which affected the production of agricultural and plantation crops. The decline in international prices of items like sugar, also brought down our export earnings. While our exports to the rupee payment countries increased from Rs. 143.88 crores in 1964-65 to Rs. 156.55 crores during 1965-66 our exports to other regions, particularly the UK, ECAFE, ECM and the Latin American countries, declined. Items like jute goods, cashew nuts, oilcakes, handicrafts, engineering goods and numerous new industrial items, such as chemicals, tyres and tubes, pharmaceuticals and drugs, etc. however, showed a steady increase.

Export Assistance

One important development during the Third Plan period has been that, in spite of severe competition from abroad and many unfavourable factors which restrict the exports of our manufacturers, India has been able to emerge out of the stage

of being an exporter of primary products to an exporter of a large number of manufactures by diversifying her exports. A significant feature in the exports of these manufactured and processed products is that we have been able to export them only through large measures of export assistance. Under these schemes, specified percentages of the f.o.b. value of exports have been allowed to these industries to utilize for importing raw materials and components in the production of export goods or a group of allied export products. Facilities were also provided for allocation of certain indigenous raw materials at concessional rates. Apart from these schemes of import entitlement, other forms of assistance given included Tax Credit Certificates, facilities for drawback of import and excise duties, railway freight concessions and cash assistance from the Marketing Development Fund. There have also been other voluntary schemes of cash assistance such as in the case of cotton textiles, bicycles, plywood etc. It is estimated that, out of our total exports of Rs. 807.05 crores during the calendar year 1965, about 80 per cent, i.e. Rs. 641 crores, were moving without any major compensatory assistance. On the other hand, the remaining 20 per cent of our exports totalling about Rs. 166 crores, received various forms of assistance mentioned earlier. However, there has been no uniformity in these export assistance schemes and different scales of import entitlements were given for different items based on the judgment made about the extent to which assistance was needed to make Indian goods competitive in world markets. These schemes, however, suffered from the following defects:

1. They did not allow transferability of import entitlements which prevented manufacturers and exporters from realizing the real scarcity value of foreign exchange.
2. They did not always provide the requisite degree of incentives to the manufacturers and exporters to fully compensate for the loss suffered in exports.

Impact of Devaluation

It has been officially stated by various Government spokesmen that devaluation will help to remedy India's foreign ex-

change ills by giving a fillip to export promotion. However, it has also been stated simultaneously that a major part of our export trade, comprising agricultural products or agriculture-based manufactures, did not need any direct stimulus. The Finance Minister himself stated in his broadcast that, in the case of some of our traditional items the degree of stimulus, which the devaluation was intended to provide, was not called for. It is on this reasoning that in the case of these items, Government have levied export duties.

Non-Traditional Exports to African and Asian Countries

Most of our non-traditional exports are being made to countries in Africa and Asia and we have already demonstrated to some extent our ability to compete with products from developed countries in these markets. For instance, our total exports of engineering items during 1964-65 amounted to Rs. 14.33 crores, out of which more than Rs. 10 crores were accounted for by the countries in this region.

With the exception of Japan, most of the countries in this region are in the early stages of development. As regards Japan, non-traditional items hardly figure in our export trade. More than 50 per cent of our exports to this country is accounted for by one single item, viz. iron ore and concentrates, whose value in 1964-65 amounted to Rs. 24.47 crores.

Though there are considerable possibilities for expanding our trade with the countries in Asia and Africa, everything that is produced in India cannot necessarily have an export possibility in these markets. The extent of success will depend not only on the various promotional activities of the Government and the Indian manufacturers, but also on the rate of industrial development in these countries and the degree of reduction of tariffs and other trade barriers in the important importing countries of the region. From the Table at the end of this Paper—*Appendix* 1 (p. 177)—it will be seen that our exports to Asian countries, which stood at Rs. 203.82 crores in 1964-65, declined to Rs. 187.57 crores during 1965-66. On the other hand, our exports to Africa increased from Rs. 46.23 crores in 1964-65 to Rs. 61.85 crores during 1965-66.

The following Table shows our exports of some of the major

groups of non-traditional items to Asia and Africa in 1964-65:

(Rs. lakhs)

	Group of commodities	*1964-65*
1.	Engineering items	1,003
2.	Art silk fabrics	513
3.	Fish and fish products	327
4.	Fruits and Vegetables	228
5.	Drugs and pharmaceuticals	90
6.	Chemical items	40

Effect of Devaluation on Non-Traditional Goods

Will devaluation help us to improve the prospects of exports of our non-traditional items to countries in Asia and Africa? The answer is that devaluation by itself can hardly help us to achieve this. The whole issue needs to be viewed from two aspects: (*i*) short-term, and (*ii*) long-term.

The sudden withdrawal of export assistance schemes has created a good deal of problems to a large number of exporters created a large number of problems to a large number to exporters inasmuch as it has upset their calculations in receiving the various benefits under the export promotion schemes. The facility for grant of import entitlement licences is now available only in regard to exports effected up to 5 June, 1966. One of the short-term measures, which has been suggested for being taken in the interest of maintaining our exports is that the benefit of import entitlements should be extended in all cases where firm contracts have been entered into by exporters prior to devaluation.

Coming to the long-term aspect of the problem, one has to note that devaluation, gives an export incentive to the extent of 57.5 per cent. Under the previous schemes, assistance was available at different rates for different commodities and there was no uniformity in regard to the assistance extended to various commodities coming under the category of non-traditional items. Devaluation has made the stimulus uniform. Another related question is whether devaluation will also benefit our exporters by making their goods competitive in world markets through

a price cut of 57 per cent? But a mere cut of the order does not provide the necessary bridge between Indian and international prices. There are several engineering and other manufactures which are priced out in the world markets by much more than this mere 57 per cent. This gap in prices still remains too wide and this has to be filled in by some form of assistance. In addition to this, it is known that most of our non-traditional items still contain substantial import contents and by making the imports costlier through devaluation, their cost of production will also naturally go up. These items include art silk fabrics; several engineering items such as steel castings, bright bars, steel fabrication machinery, prime steel; various chemical and allied products, plastic goods; etc. There are also items like precious, semi-precious and synthetic stones where the export trade is largely dependent on imports inasmuch as exports are made only on the basis of imported rough stones. It is, therefore, essential that the various incentive schemes would have to be suitably recast to meet the requirements of those sectors where the advantages provided before were much higher than the benefits which would accrue from devaluation.

It was announced by the Government of India on 5th June that alternative schemes for export promotion were being worked out to ensure adequate allotment for imports of raw materials, components, machinery and equipment to exporters. Though the Government have liberalised the imports of certain essential items, it is unlikely to meet the entire requirements of export industries and exporting units. Special assistance must be given to these, both in the form of import entitlements and continuance of the facility for procurement of local raw materials, freight assistance and also assistance from the Marketing Development Fund.

Incidence of Import Duties

Another problem which is of equal importance is the general rise in the incidence of import duty. It is, therefore, necessary that there should also be a liberal system of grant of rebate of import and excise duties on an *ad hoc* basis by taking into account the increased cost not only of the direct raw materials that have gone into the manufacture of the production, but also

on other items used in the manufacture of the product.

Scope for Joint Ventures

Against the above background of increasing the competitive capacity of Indian manufacturers to countries in Asia and Africa, there is another aspect which must be kept in view in any analysis of our trade relations with these regions. It must be stated that, in view of the similarities of problems, there is a fund of goodwill in many of these countries for India. In this connection, the observations made by an FICCI-sponsored Industrial Goodwill Delegation which visited several African countries in 1964 to make on-the-spot investigations, will be worth quoting. The Delegation stated in its Report that "trade can form only a part of the total economic relationship which must extend itself to other forms of collaboration in investment and technical assistance". Most of the countries in Africa and Asia have liberal investment facilities and no further time should be lost by India in going ahead with the projects of economic and industrial collaboration. Trade can be built on a more strong foundation in those countries where Indian capital and know-how are recognised, accepted and welcomed. Devaluation should prove as an incentive to Indian investors in undertaking such projects because of the better returns that Indian parties will now get in terms of the rupee. In the mater of export of capital equipment, however, there would still be need for some assistance.

Conclusion

The major issue of policy which will have an impact on the exports of our non-traditional items, for which the developing countries of Africa and Asia offer considerable opportunities, is the formulation and proper implementation of export assistance schemes. It is quite on the cards that devaluation has not enabled many of our non-traditional exports to become fully competitive. The disparity between the international and the internal price continues and this has to be bridged. In addition to making raw materials available to the export industries, there would be need for other forms of support including cash assistance. This has to be worked out in a simple manner. At the same time,

it is incumbent to device approximate arrangements so that all tax elements in exports are segregated and facilities for refund ore available to the parties expeditiously.

Internally, it is of utmost importance to strive continuously for keeping down export costs and to increase production and productivity with special emphasis on export industries. In the context of the need for developing our two-way trade with the developing countries of Africa and Asia through various methods including the establishment of joint ventures, we have also to adopt requisite methods for promoting economic cooperation. On this subject, a report has been submitted in April 1966 by an Expert Committee appointed by the United Nations on "Trade Expansion and Economic Cooperation among Developing Countries".

Expansion of trade can be promoted through the following methods:

a) Trade policy measures not conditional upon commodities regarding the harmonization of other policies.
b) Coordination of investment and/or production programmes, supplemented by measures relating to the exchange of the goods concerned.
c) Regional integration of national markets.

While there may be problems and difficulties in implementing the various suggestions made, it would be desirable to follow concrete measures so that the developing countries may at least be in a position to expand their trade *inter se*. Much will depend upon the political and other factors which are unpredictable in nature. However, it can be stated that increased trade relations between the developing countries would in its turn open up new dimensions of economic and political relations.

APPENDIX I

DIRECTION OF INDIA'S EXPORT TRADE TO COUNTRIES IN ASIA AND AFRICA

(*Rs. lakhs*)

	1964-65	1965-66
ASIA (Selected Countries)		
1. Afghanistan	5,87	5.59
2. Australia	19,99	17,54
3. Burma	6,41	3,60
4. Ceylon	14,43	12,85
5. Malaysia	15,07	12.25
6. Hong Kong	5,85	5,68
7. Cambodia	1,97	1.02
8. Indonesia	1,80	81
9. Iran	4,85	5,99
10. Japan	60,90	56.98
11. Nepal	16,62	19,66
12. New Zealand	5,38	6,57
13. Pakistan	9,75	4,86
14. Thailand	2,83	1,58
15. Vietnam, South	3,88	2,87
16. Aden	6,02	5,90
17. Bahrain Islands	2,07	1,64
18. Iraq	3,47	4,32
19. Kuwait	4,13	4,85
20. Qatar & Trucial Oman	2,90	2,90
21. Saudi Arabia	3,27	3,95
22. Syria	99	1,16
TOTAL	203,82	187,57
AFRICA (Selected Countries)		
1. Egypt (U.A.R.)	14.24	27.07
2. Ethiopia	1,33	1,17
3. Ghana (Gold Coast)	29	1,12
4. Kenya	5,30	4,88
5. Mauritius & Dependencies	1,09	94
6. Nigeria	5,12	4,01
7. Sudan	6,35	8,17
8. Rhodesia	2,20	1,35
9. Tanganyika	2,60	4,35
TOTAL	46,23	61,85

Proceedings

Speech

R A M N A T H   A.   P O D A R
President, Indian Merchants' Chamber

FRIENDS AND DISTINGUISHED GUESTS:

I have great pleasure in welcoming you all. I am thankful to you for having made it convenient to attend this Seminar and share with us your views on the important and controversial subject of devaluation. I am particularly grateful to Shri P. C. Bhattacharyya, the Governor of the Reserve Bank, who has kindly consented to address the Seminar which will initiate a fruitful dialogue on the appropriate follow-up measures that would be required to realize the full benefits of devaluation. We had arranged a seminar on 'Monetary and Credit Policy' in May last and the discussions were very useful from the point of view of focusing attention on an aspect vitally affecting industries and I hope that the discussions on the present occasion will prove to be equally fruitful.

Devaluation Has Provoked Strong Reaction

2. Until the decision of devaluation, it was the official view that such a step would offer no solution to our current economic

difficulties, caused by inflation, the drought, the resultant increase in food imports and the war with Pakistan which was accompanied by a 'pause' in foreign aid. Coming as devaluation did, in the face of protestations to the contrary, it is no wonder that it (by as much as 57.5 per cent) came as a rude shock. It provoked strong reaction in the press and the public. This is not unusual because the present decision of devaluation, unlike the earlier decision in 1949, is going to affect every aspect of our economic life and that too with far-reaching consequences.

Why Devaluation was Resorted To?

3. Devaluation had to be resorted to, in the words of the Prime Minister, 'as a lesser evil' and 'it had become inevitable to wriggle out of the morass in which the country was writhing'. Explaining in the Lok Sabha, on the second day of its current session, the circumstances which led to the sudden devaluation of the rupee, the Finance Minister observed that on the latest reckoning, agricultural production declined by nearly 15 per cent in 1965-66, industrial production increased by only 3.8 per cent and the real national income declined by more than 4 per cent. In the face of such a sharp reduction in real resources, wholesale prices increased by as much as 15 per cent in one year and exports declined, in spite of growing assistance and support. We had to tighten import restrictions further even in respect of essential raw materials and components. We had to borrow $ 187.5 million from the I.M.F. in April last. The balance of payments position was becoming more and more untenable as a result of the rise in prices. The traditional and non-traditional exports were experiencing growing resistance in foreign markets, necessitating a further stepping up of the subsidies. Also it became evident that without substantial imports of fertilizers immediately on the basis of aid, the agricultural programme would not get going. With a stagnant agriculture, the Government were afraid, internal inflation might go out of hand. The commitments ahead for debt repayments were heavy. In addition, aid in the pipeline was smaller. According to the Finance Minister, in the markets abroad, the rupee was selling at half its value and smuggling was on the increase; even the NDR scheme was not the expected success. Prices inside the country

were constantly rising and the parity value of the rupee was not realistic. It was even felt that without aid or aid in much smaller amounts, the Plan would necesarily be truncated and the same would not meet the requirements of the situation. Thus we are given to understand that the most important thing which prompted the sudden decision to devalue the curency was the 'pause' in foreign assistance and the uncertainty of its resumption without devaluation.

Devaluation A Fait Accompli

4. Devaluation has become a *fait accompli*. The die is cast and we have to reckon with devaluation as a fact. The important question now before us is how are we going to face the challenge of devaluation? By now, it is clear, in the words of the Governor of the Reserve Bank, that 'devaluation is no panacea for the economic ills confronting the country', though it is expected to confer, in the long run, certain benefits. However, the realization of benefits would depend upon the extent to which the economy is able to adjust to the changed conditions without generating disturbances in the process. This, in turn, would depend upon the post-devaluation economic strategy and follow-up action.

Corrective Measures should Suit Indian Conditions

5. In considering follow-up measures, reference has been made to the favourable experience of devaluation in Britain, France and Yugoslavia and a parallel is drawn to similarity of decisions to devalue the currency. In this connection, it is pointed out that there are significant differences in economic conditions in various countries and the remedies which might have proved effective in those countries might not be applicable in the Indian context. These countries, unlike India, have a solid industrial base. Their economies, unlike our economy, are well organized and closely integrated. They are free from population pressures, mass poverty, shortages of electric power, raw materials, technical know-how, etc. They had the certainty of massive economic assistance from friendly nations. In other words, their productive structure possessed sufficient foundation

and elasticity to be able to cash in quickly the benefits flowing from devaluation. Unfortunately, these conditions do not obtain in our country. We are facing run-away domestic inflation, shortages of food and raw materials, essential spare parts and components, low foreign exchange reserves, uncertainty in foreign assistance, mounting foreign debts and an economic structure which is far from integrated. The follow-up measures will have to be framed in the context of the conditions prevailing here.

Follow-up Measures Taken By Government

6. It is true that the Government have followed the announcement of devaluation by liberalization of import of raw materials, components, etc., required by certain priority industries. The Central Government have also decided to take steps such as introduction of economies in the Central and State Budgets, maximization of returns from existing investments, postponement and staggering of even developmental expenditure if and when found necessary to promote balanced budgets and avoidance of unauthorized overdrafts of State Governments from the Reserve Bank. Apart from these, no 'follow-up' of 'package of measures' has been devised and implemented by the Government in the last two months. One wishes that our Government had acted energetically in devising appropriate fortifying steps to take quick advantage of the decision of devaluation.

Need for Urgency in Evolving Corrective Measures

7. Time is of essence in taking corrective steps. In the absence of co-ordinated direction and action, the masses already steeped in poverty, will lose confidence if matters fail to improve after devaluation. In the developing economy of a democratic country, where there is a persistent need for raising the standard of living of the people, it is a moot point as to where the line can be drawn for tightening the belt! How far restraints on consumption can be feasible and how far exportable surpluses can be created? Both are essential and a via media has to be found in the larger interest of the country. It is also a matter for consideration whether different industries, among themselves, can

evolve schemes, consistent with the overall demand in the country, under which it becomes imperative to set aside a certain percentage of production for export purposes. If energetic follow-up measures to improve the economy are not forthcoming soon, the inflationary pressures will persist with increased intensity and soon a time may come when further devaluation of the rupee may take place, much to our distress. The serious implications of such a development for our political and economic stability, particularly in a democratic set-up, need hardly be underlined. Hence the importance and urgency of measures which could help achieve fully the expected benefits of devaluation.

Benefits Expected to Flow from Devaluation

8. Devaluation is claimed by Government to secure several advantages such as giving a fillip to export, improving foreign exchange earnings, encouraging investment in export-oriented industries and promoting a greater degree of self-reliance. Devaluation is also expected to confer a definite gain in respect of profits, royalty payments, etc., in respect of private foreign investments and encourage remittances to be channelized through official channels. Let us now examine the possibility of achieving the expected benefits of devaluation. This is necessary with a view to finding out the factors which may limit the scope of the expected beneficial impact of devaluation, and in the light of the same to formulate measures so that the benefits are, in fact, effectively realized.

Increasing Exportable Surpluses

9. Let me refer to the position with regard to the scope for increased exports consequent on devaluation. Expansion of exports depends upon various factors such as elasticity of supply of our exportable goods and of demand for our products from abroad. It is of paramount importance that exports are competitive in foreign markets and devaluation is expected to provide a price-edge to exports, which were till then priced out from the world markets. Apart from the price disadvantage, the various factors hampering India's exports are: stagnation in domestic

agricultural production, increased utilization of exportable raw materials for domestic industrial production, relatively static world demand for the major traditional products exported from India and the shrinkage in total world trade in commodities like cotton textiles and protectionist trade policies followed in various countries. However, the most important factor standing in the way of increased exports from India is the domestic supply position. Seventy-five to eighty per cent of our exports are derived from agriculture in one way or another. If exports have to be increased, it is urgently necessary to implement a crash programme to increase agricultural production and thus to augment the exportable surpluses.

Tapping of Vast Mineral Resources

10. Along with increasing agricultural production, a source of considerable possibility and which requires to be increasingly tapped is that of resources hidden under the surface of the earth such as the vast mineral resources. Could we not explore more fully the possibilities in this direction? This in turn would facilitate securing essential imports and in providing for rising domestic consumption which is inevitable when population is increasing. After devaluation, it is obvious that most of our imports will be dearer than before. This is expected to act as a restraint on imports. It is well to remember, however, that most of the imports at present are made up of essential raw materials and components which are necessary for facilitating fuller utilization of capacities and thereby increasing production. Devaluation would have no meaning if raw materials, components and spares are not imported in adequate quantity with a view to permitting existing industrial apparatus to be exploited to the full, although such imports should be replaced by indigenous production at the earliest.

11. At least for some years, the re-activization of the economy would depend upon the quantum of foreign assistance. In the long run, devaluation is expected to give a boost to import substitution in domestic industries thereby lessening our dependence on foreign aid and assistance. It is obvious that there is urgent need to eliminate unnecessary imports whether it is for consumption or industrial expansion. Having devalued the currency, the

nation has to tighten the belt. Otherwise, devaluation will lose all its meaning.

12. One of the goals of devaluation was to reduce the foreign exchange burden arising from repatriation of profits, capital and royalty payments. This will be so in relation to capital borrowed from private investors. So far as borrowings from international institutions are concerned, the burden of repayment will increase by 57.5 per cent. For instance, in the case of TISCO, it is expected that liability for loans obtained from the World Bank would increase by over Rs. 11 crores on capital account and for future interest payments our outstanding foreign debt obligations were estimated at Rs. 2,734 crores. As a result of devaluation, these obligations would increase to Rs. 4,103 crores. This would necessarily entail effort by the Government to raise extra resources to finance the increased debt burden.

13. The Finance Minister has observed that foreign investors would now be able to realize more rupees for their investments and this would serve to encourage new foreign investment. But an average foreign investor, it is relevant to remember, having persuaded himself to effect the initial transfer of funds to India, would be interested in the recurring repatriation of rupee profits and dividends and it is well to remember that every rupee that he so earns will purchase less foreign exchange than before.

Rise in Prices

14. We have been informed that the general level of prices in India was over 75 per cent higher than it was a decade ago. In the three and a half years, since the Chinese aggression, there has been an increase of 50 per cent in the price level and in the last year about 15 per cent. In contrast, there was an increase of 27.2 per cent in Britain, 9.7 per cent in the USA, 10.3 per cent in West Germany and 18 per cent in Pakistan in the last decade. It was planned that during the Third Plan, the money supply would increase by 35 per cent and it was assumed that this would be balanced by the corresponding increase in real production. But things turned out otherwise. While the money supply went up by 57 per cent, the real national income rose by 15 per cent as against the target of 30 per cent. Given the inflationary pressures already operating in the economy, it is not surprising that

prices have risen after devaluation. Although quick decisions have been taken for making available larger supplies of essential commodities such as kerosene, vegetable oils, etc., so that the consumers are not put to hardship and to subsidize a large number of essential items of common consumption to hold the price line, the major task is to break through the vicious circle of rising prices giving a stimulus to inflatonary pressures, making the lot of the common man more difficult.

Long-term Measures for Correcting the Imbalances in the Economy

15. It is relevant to recall that certain practical suggestions have been made by responsible persons in public life, to gain maximum advantage of the post-devaluation situation. These suggestions in brief stress the need to avoid deficit financing in the next few years, balancing of the budgets at the Centre and States, cut in Central and State Governments expenditures, provision of liberal credit to cultivators, fiscal incentives to industry for increased production, subsidization of necessities of life to employees, encouragement to exports and import substitution or promotion of self-reliance.

16. Government have declared that they will not undertake any deficit financing in the Fourth Plan and they have also announced that export-oriented industries will be encouraged. But what is required is an integrated approach to the whole post-devaluation situation, as remarked before, and not a piece-meal approach. In this connection, I would like to make a pointed reference to the drastic measures recently adopted in the UK, by the Labour Government, to combat inflationary pressures. In sharp contrast, it is unfortunate that the Government here appear to adopt all along a policy of appeasement of labour without any corresponding rise in production and productivity even at a crucial juncture like the present.

Dimensions of the Developmental Effort in the Fourth Plan

17. With the devaluation of the rupee, the entire cost-price structure of the economy, present and prospective, has under-

gone a change. This has distorted the calculations of the Fourth Plan. In spite of persisting inflationary pressures evident in the economy, the Planning Commission has fixed a target of Rs. 16,000 crores as minimum investment necesary for the public sector. There is no decision on the size of the private sector programmes which are, however, expected to be somewhat larger than Rs. 7,000 crores approved in September last year. The overall outlay includes a foreign exchange component of Rs. 4,000 crores including Rs. 1,300 crores for repayment of liabilities. The proposed outlay will necessitate mobilization of additional resources totalling Rs. 1,800 crores, including Rs. 600 to 700 crores by the States. Here is an instance of considerations of discipline being not given the importance they deserve and which have been emphasized by the experience gathered so far. I am afraid that a Plan of the dimensions envisaged, without proper precautions, will set in motion further inflationary forces which we are all anxious to avoid. I submit that the Government and the Planning Commission should eschew grandiose plans and concentrate realistically on implementing those projects which are likely to yield quick results and which remained incomplete for one reason or another during the Third Plan, correlating the effort with the real resources in sight. The scope for effecting economies and avoiding waste is very large and this together with a more purposive and efficient implementation of the development programmes would considerably assist in pruning the high targets of expenditure envisaged in the Fourth Plan. What is important is not whether the Plan is big or small; what is really relevant is that the Plan should be realistic, based on real resources available and impemented with maximum efficiency.

Need for Review of the Fiscal, Monetary and Credit Policies

18. Devaluation is not expected to materially affect the budgetary position either way. At the same time, it has emphasized the need for a radical review of the fiscal, monetary and credit policies. In an effort to meet the resources for developmental activities, taxation levels have been pushed up from time to time and it is a patent fact that a large portion of the resources so raised has been diverted to non-Plan, non-development expendi-

ture. A good part of the expenditure is purely of a demonstrative nature. The high rates of taxation, both in the direct and indirect spheres, have been beyond the bearing capacity of the people and have been drying up the resources for productive purposes and bringing about an inflationary impact on the economy, giving a push to the price upsurge. While direct taxes have been at prohibitively high levels, indirect levies, such as excise duties, have only brought about an increase in prices and not a reduction in the consumption demand, as envisaged. In this context, is it not high time that a new approach is brought to bear on the taxation structure in the context of the imperative need to rehabilitate the economy which is the crucial problem facing the country?

19. As far as monetary and credit policy is concerned, there is an important question arising out of devaluation, namely, the financing of the likely increase in imports in its rupee equivalent, consequent on devaluation. In the immediate period, assuming that it will be possible to finance additional imports on a large scale through non-project aid, our capacity to find the complementary domestic resources will remain a severely limiting factor. Some method of enabling the private sector to finance the part of imports due to higher cost of devaluation has to be found. The fuller utilization of domestic resources will also call for more credit. The increase in exports will also need additional rupee finance. A better agricultural production may call for more funds. Additional credit should, therefore, be provided by the banking system to sustain the tempo of increasing production. In this connection, it is worth while examining as to how far the existing credit policy has impeded the flow of funds for productive purposes and in that context to consider the advisability of suitably bringing about the necessary changes in respect of the conditions of advances, debt-equity ratio and term loans. It is to be hoped that the new policy on the anvil takes into account all these developments. In this connection, the need for term finance being made available to industries on comparatively easier terms is emphasized. How far this objective is compatible with the conditions prevailing in the money market and higher dividend expectancy is a point which requires to be seriously cosidered.

20. It must be noted that devaluation is only a temporary ex-

pedient. It will not give any permanent advantage. The only way out is to have a realistic course of action to avoid inflationary pressures. Inflation could be controlled by an increase in production, both agricultural and industrial, and removing all obstacles in the way which are inhibiting production. Thus it is necessary to remove irksome controls affecting production and hampering the free operation of market force. Industrial licence, for instance, can be granted freely where no consideration of foreign exchange is involved so as to step up exports and stimulate import substitution. To secure cost reduction, industrial units should be economical and the older units should be allowed to be expanded to an economic size together with necessary modernization and rationalization. Setting up of exclusively export-oriented industries should be encouraged in every possible way. What is needed is to find out avenues where India has a comparative advantage and which have definitely widened after devaluation and to encourage growth in those areas. It is only on the basis of clearly defined and integrated approach to our basic problems that we can hope to overcome the weaknesses that have come to the surface.

Certain Vital Questions

21. In conclusion, I would like to re-emphasize that inflation is the root cause of imbalances and economic malaise which has led to a great national crisis. How shall we counter inflationary pressures? How shall we reorientate our approach to planning and development so as to inject a new dynamism into our economy and revitalize development with a sense of purpose? Shall we be able to locate factors which have impeded production and devise ways and means in concrete terms to step up both agricultural and industrial production and productivity which alone, in the final analysis, provide an effective answer to inflationary pressures and provide exportable surpluses? Shall we be able to free the economy from irksome and frustrating controls so as to release the productive forces to contribute their maximum? Will the Government be able to eschew deficit financing completely and will the Centre and the States subject themselves to rigorous self-discipline and set an example to the people that they are in right earnest about curbing inflation in the economy? Will the

Government realize that in planning for development, modest ambition is not a crime but failure of performance, which engenders utter sense of frustration, is certainly a crime of great magnitude? Will the Government bring a sense of realism in planning and adjust their ambitions to the real resources available? What would be the appropriate fiscal, monetary and credit policy, so as to assist the process of economic resurgence by promoting savings and investments in productive channels? What steps would be necessary to revive the capital market? How shall we launch on a dynamic export programme? How can we step up both our traditional and non-traditional exports? Will the several State Governments realize the importance and urgency of export promotion and do everything in their power to assist the Central Government in their efforts at facilitating increased exports? How should the Government, Industry and Trade and the citizens co-operate in seeing that no unjustifiable price-rise takes place affecting the cost of living of the common man? A question that arises is how effectively will we tackle the population problem? Will all-out efforts be made to contain the growth of population and thus prevent it from being a drag on the progress of the economy? Overall, even such economic progress as is possible to have in the near future, will be conditioned by the prevalence of circumstances congenial for the purpose. This stresses the importance of undisturbed conditions of work in all spheres of activities. The development of disturbances from time to time and place to place in recent past can hardly be conducive to concentrate efforts for hard work, increased production and in fact economic progress all-round. Will concerted steps be taken to improve the situation in this regard?

22. I can go on posing a number of questions arising out of 'The Challenge of Devaluation' which we have to face. We have not only to arrest any further deterioration in our economic position and salvage the sinking rupee, but we must be able to adopt a positive programme of action so as to be able to strengthen the rupee and in course of time be able to ask for its re-valuation. It is indeed an uphill task. This is a national challenge. It is a challenge to the Government; it is a challenge to the industry; it is a challenge to trade; it is a challenge to labour and it is a challenge to the citizen. Shall we be able to

galvanize ourselves into a disciplined nation and rise to the occasion? I have tried to pose a number of problems and thrown out a few suggestions in the hope that they may provoke discussion and enable us to come to an objective assessment of the situation created by devaluation.

23. Several experts have prepared the background papers to highlight the various aspects of devaluation. I am sure that they would help in making a significant contribution to existing thinking on the subject. I would like to express my grateful thanks to all those who have submitted papers. I would now request the participants in the Seminar to concentrate discussion on ways and means of evolving a meaningful post-devaluation strategy. May I express the hope that as a result of the discussions, this Seminar will be able to recommend appropriate steps and measures necessary for deriving the maximum national advantage out of the measure of devaluation? Before I conclude, I would like to express once again my grateful thanks to all the distinguished guests who have made it convenient to attend the Seminar.

Address

P. C. BHATTACHARYYA

Governor, Reserve Bank of India

MR PRESIDENT AND FRIENDS,

First of all I should like to say how glad I am to have this opportunity to address this Seminar on the 'Challenge of Devaluation.' The devaluation of the Indian rupee in June this year is the most significant event on the Indian economic scene at the present juncture. This action is bound to have far-reaching effects on the country's economic development. It is, therefore, very necessary that representatives of industry and business meet together and take counsel as to how to conduct their affairs in the new circumstances that have arisen. By arranging a Seminar on this challenging topic, the Indian Merchants' Chamber, in my view, has rendered a signal service to the industrial and business community. And I should like to compliment the President of the Indian Merchants Chamber on his promptness in doing so.

For such an audience as this it is hardly necessary for me to spend much time on the causes which led to devaluation. I have dealt with these in some detail a few days ago while addressing the Bombay Bankers and I need not repeat what I

had said then. Briefly, devaluation became necessary because of the strong inflationary pressures prevailing in the economy for some time now and their harmful effects on the country's international accounts. The function of devaluation is to offset the impact of inflation on the external sector of the economy. However, it is a once for all adjustment. Unless, therefore, there is swift and decisive action to check the forces which have been contributing to inflation, the effect of the adjustment will be set at nought in a short time. The reduction of inflationary pressures thus assumes the first priority in any follow-up action after devaluation. A thorough discussion of this problem in all its aspects will, however, take a considerable time. I propose, therefore, to content myself with pointing out that devaluation has in fact increased rather than decreased the need for overall fiscal and monetary discipline. If we are to avoid a repetition of our difficulties we shall have to make strenuous efforts to place the economy on a stable basis. With prospects of a reasonable monsoon and larger availabilities of imports of raw materials and components following resumption of external assistance the supply side of the picture looks hopeful. But this has to be accompanied by effective action on the demand side also to bring about price stability. Both the public and private sectors have to co-operate in this matter by pruning down or postponing expenditures on consumption as well as on investments with a low productive potential.

Having said that, I should like to turn to a discussion of the steps that need to be taken in the field directly relevant to devaluation, namely, the country's balance of payments. To take exports first, the recent halt in the progress of our exports has been a continuing source of worry. After several years of stagnation exports had begun to show a welcome increase in the early years of the Third Plan. However, during the latter half of the Plan the progress came to an abrupt end despite an increase in the coverage of schemes for export promotion. What was more disturbing was the fact that even our traditional exports of tea and jute goods required such help and there was persistent demand for increases in incentives that were being given. This was not surprising as inflation had been making serious inroads on the competitive power of our exports. A stage had been reached where export subsidies either in the

form of incentive licences or tax credits or cash subsidies had to be given practically for all exports even to maintain the exports at the existing level. In such circumstances, a formal devaluation was the only straightforward course.

With a major impediment in the way of our exports having been removed through devaluation of the rupee, it is now for all of us to consider how best we can increase our exports. Ultimately, it is our exports which have to pay for our essential imports, the volume of which is bound to grow with development of the economy and also to provide the wherewithal for the mounting debt service obligations. The first thing that is necessary in this connection is to realize that exports are a national problem and all sectors of the economy have to co-operate to find a lasting solution to the problem of export promotion. Here I cannot help but say that lack of appreciation in many quarters of the key role that exports play in the country's economic development has given rise to an attitude of apathy or indifference to them. Thus, sometimes, exports are prohibited in the interests of domestic consumption. Not enough interest is taken in investigating and developing export possibilities of particular commodities or of particular regions. Exports, of course, mean a certain amount of sacrifice. For the economy as a whole exports mean a reduction in the available supply of goods for domestic use. For the industry they mean sacrificing the easy profits of a sheltered market and instead making a hard struggle to keep one's flag flying in foreign countries in the face of severe competition. But these sacrifices are worth making because the return that they bring far outweighs the temporary inconvenience. And here I am not thinking merely of the foreign exchange that we would earn from higher exports but also of the many intangible benefits which exports confer on an economy. A country which is able to withstand competition in international markets as regards its exports has in my opinion already gone a long way towards self-reliance which is the basic objective of development. It is only men of first rate ability, who can become good exporters, who can establish themselves firmly in world markets. Good exporters are thus a valuable asset to the nation and the more such people we have the better will it be for the country's development.

I have stressed the national context of the export problem

because it is only when we do so that the requirements of export policy become clear. It is obvious that, a lasting solution to the problem of export promotion cannot be obtained, unless there is a concerted effort, at all levels of Government and business, to explore to the fullest extent the export potential in their respective spheres, and to devote enough resources, in men and materials, for the purpose. It is only when this is done, that the oft-repeated complaint, that we do not have enough exportable surpluses, will disappear. An exportable surplus is not something that happens all by itself. It is the joint result of developing an export market and internal production of the export item concerned. Given the necessary effort, there is no reason to think that our economy, with its variegated agriculture and industry, is not capable of producing export surpluses in many more lines than what it is doing at present.

While the broad decision as to the quantum of resources to be diverted to exports is the responsibility of the planning authorities, its successful execution, that is to say, actual investment, production and marketing, is the responsibility of individual units in industry and business. This poses the greatest challenge to entrepreneurial ability. Although our exports had shown some expansion in the Third Five-Year Plan, by and large, it is the exports of traditional items which account for the major share of earnings, whether from the traditional or from the new markets. The percentage of exports to output, from the new industries that have been set up during the three Plans, is generally quite low. In engineering industry, for instance, it is only about 2 or 3 per cent. Moreover, such export of new items as has taken place, has had to be assisted in a considerable measure by incentive schemes as well as other types of subsidy. This indicates that we have a long way to go in the matter of organizing our export effort.

High costs of production and the pull of the domestic market had been the *raison-d'être* of the incentive schemes. Devaluation would help in reducing the adverse impact of high costs to the extent they are domestic in origin. Further reduction in costs has to come from better organization of production. In this matter the outlook is more hopeful now as a result of increase in the flow of non-project assistance. This should enable industry to expand its scale of operation and benefit from economies of

scale. I am aware that even this may not make all our exports fully competitive in the outside world as the export market is a highly competitive one, and it may be necessary to maintain prices in the export market for some commodities, at a level, which may involve industrial units into some loss at times. It is here that an appreciation of the wider aspects of export policy is called for on the part of Indian industry. It has to be realized that unless industry makes it a point to export a certain proportion of its production regularly, irrespective of other considerations, there can be no hope of balancing our international payments position ever. This is a must for our industries. Even if some loss occurs in this process the export effort should not be given up. Rather than wait for such losses to be made up from some external source, industry should initiate steps to increase efficiency making in the meanwhile appropriate internal adjustments on its own to recover such losses through the prices for the domestic market. This cannot be a heavy obligation on industry considering the small proportion of their production which industry may be called upon to export. Such an obligation to frame a voluntary scheme of compulsory exports—if I may describe it in this manner, has to be accepted by each industry and discharged in such a way as to result in a continuous increase in exports, if we are not to be pushed towards a closed society in respect of our international dealings.

I am told that there are cases where in spite of devaluation and utilization of full capacity, losses will be incurred continuously and that therefore such exports will need assistance on a large scale for a long time. If this is so, it is worth while considering whether such exports confer any benefit at all on the economy. Exports at any cost is in my view an ill-conceived principle. It breeds the tendency to rely on schemes of assistance rather than on productivity increases for sustaining exports. It evokes resentment from competing countries and disrupts international economic co-operation. And finally, it carries within itself the seeds of further devaluation because continuous and heavy subsidization of exports is evidence that the rate of exchange is unrealistic and that the opportunity cost of foreign exchange is considerably greater than is implied in the rate. I think we should be better off in the long run without such exports than with them.

Before turning to the next topic, I should like to say a few words about export finance. In many discussions on the subject I find that there is a considerable degree of misunderstanding particularly as regards the relationship between measures of credit control and export finance. The objective of credit control is not merely to control the overall volume of credit expansion in the interests of monetary stability but also to direct its flow to the various sectors according to their priorities in the country's economic policy. Exports have always been accorded a very high priority in the credit control policy and various tools such as moral suasion and concessional unlimited refinancing through the Reserve Bank for short-term export finance at the pre- as well as post-shipment stage and through the Industrial Development Bank for longer term finance have been used to make the policy effective. Moreover, the policy is constantly under review so as to adjust it to the needs of the situation. Thus, for instance, in the light of the changed circumstances consequent upon devaluation I have assured adequate refinance at Bank rate to all categories of export bills purchased by the banking system. Similarly, in framing the structure of rates at which the commercial banks buy sterling export bills and fixing the rates at which the Reserve Bank buys sterling from the banks the interests of the export trade have been safeguarded.

I shall now turn to the imports side of our balance of payments position. Not only do payments for imports continue to remain high but the proportion of imports required to maintain the economy has increased. We have now reached a stage where even the requirements of maintenance imports cannot be financed from the current earnings of exports. Moreover, as servicing obligations in respect of external assistance obtained in the past mount up, the availabilities from current exchange earnings for such imports will be progressively reduced. This emphasizes the need for a searching examination by industry of the problem of import substitution, in addition to steps that may be taken for export promotion.

As a result of devaluation the disparity between the rupee prices of indigenous products and those of imported products has narrowed in favour of indigenous products. This should encourage the use of local products. There are, however, even more important reasons why industry should give preference to

indigenous materials even if import licences are available for foreign materials. I have already referred to the question of maintenance imports. Unless exports expand quickly, the future of such imports depends on the availability of foreign assistance. This means that continuity of suplies of foreign materials cannot be taken for granted, which in turn means that any manufacturer who bases his production programme on an assumption of continuity of supplies of imported materials may well find himself in difficulties sooner or later. It is, therefore, of utmost importance that every effort is made to develop stable indigenous sources of supplies. I am aware that a good deal has been done, particularly under conditions of scarcity, to conserve imported supplies and to use indigenous substitutes. It would be a pity if that momentum is lost because temporarily industry is in a position to obtain imported materials. In the second place, to the extent industry buys local materials it will keep up production and employment. Self-reliance is also self-help. By switching from domestic products to imports there is every danger of unemployment and loss of production being induced in import substituting industries. This canot fail to have wider repercussions. If you do not use products manufactured by your colleagues you can hardly blame others if they do not use your products. This applies particularly to the large industrialist, who has to play a developmental role in the industrial set-up of the country. It is his duty to see that he provides the necessary market for the ancillary industries that are essential to make the economy a broad-based one. If he does not do that and puts a whole lot of small scale industry out of business by going in for imports he will have only himself to thank for the resultant depression which the economy may then be faced with. It may be argued in this connection that there is still some cost disparity between imports and indigenous production in spite of devaluation. However, it should be remembered that costs can be reduced over a period with assured large-scale operation.

A closely related field is that of foreign collaboration. It is true that indigenous production with foreign collaboration is better than importation of the whole of the product. Foreign collaboration has an important part to play in any scheme of industrialization. But the time has come I think to take stock of the situation and ask ourselves the question whether we are

not overstressing the need for foreign collaboration. With plants producing steel, aluminium, machine tools and various types of industrial machinery, can we not expand in the lines where we have been accumulating experience and improve the quality of those products on our own rather than go in for new schemes of foreign collaboration for the same types of products? Every arrangement for foreign collaboration means two things. In the first place, it means that the future balance of payments of the country is burdened with an increasing quantum of payments. Secondly, it means a setback to local initiative and to Indian industry. The first is a visible burden. But the second is no less important. It retards the pace of development just as much. It puts the goal of self-reliance back. To the industrialist, there is a great temptation to go in for foreign collaboration because he saves all the costs of development. It is also a fact that the pace of industrial production can be quickened by helping industry to be established with foreign collaboration. Also, in the kind of sheltered market we have, industry does not like to bother about improving the quality of its product and hence one way to force it to do so may be through setting up competition with the help of foreign collaboration. But this is to take too narrow a view. In the larger context this is a waste. It would be much more in the interest both of the industries and the nation that industry made a concerted effort to get away from the habit of going in for foreign collaboration for every little thing and spent some of its resources on research and development. The country has been equipped with modern laboratories in many scientific fields. The necessary brainpower too is available. Indian scientists and engineers can stand comparison with those in the most advanced countries in the world. Not to use them and go after foreign collaboration for every little thing seems to me to indicate a lack of progressiveness as well as of foresight.

The challenge of devaluation in short is a challenge to our ability to stand on our feet. The success with which we are able to contain inflation, increase exports and reduce dependence on others for imports will determine how soon we can do so. The need to hasten our progress towards self-reliance is all the greater now than formerly. I would therefore like to make an earnest appeal to you to think over these points which I have

placed before you objectively and not dismiss them as mere sermons delivered from a high pedestal to be listened to and then forgotten.

Discussions

Shri G. L. Mehta

I shall confine my observations on the ways and means of evolving a meaningful post-devaluation strategy. Post-mortems are not very pleasant except for some doctors and political post-mortems are useful to some politicians and to all those who want to find scapegoats. The purpose of the Seminar is not to find scapegoats or score points, but to ascertain as honestly as we can, our task and obligations in view of what has happened. Experience is the name men give to their mistakes and we have to see that we do not repeat such mistakes and we are both sadder and wiser by our experience.

In June when Government decided to devalue the Rupee, our economic problems were not solved because devaluation is not a substitute for economic action. It is, I feel, of no avail now to argue whether it was inevitable or not. In any event, it became unavoidable for various reasons. If we go into these reasons, it is only in order to ascertain and satisfy ourselves and understand the factors and forces which made it inevitable. There are inflationary pressures persisting even today and if another devaluation is necesssary which, I hope will not be the case, then it will not be a devaluation, but it will be a disaster for this country.

It is already two-and-a-half months since devaluation took place and we have to see whether we have done anything concrete in respect of follow-up action. The question of planning has been rightly referred to in this connection. Now, planning has been called the horoscope of the nation. But like horoscopes,

it has not been too accurate. The less successful we have been in reaching the targets in one Plan, the more ambitious our Planners have been in raising the targets in the next Plan. As London *Statist* said some time ago, 'Think of a Plan and double the targets'. I remember when I was a Member of the Planning Commission and when we were discussing the Draft outline of the First Plan in 1951, a British businessman remarked: 'It is better to have modest targets which you can achieve rather than ambitious targets which you cannot achieve and which leads to frustration and disappointment'. Any Plan that we frame today has to have some relevance to our resources—resources both available as well as such resources as are in sight, as we can mobilize and even augment. For, resources can also develop with economic growth and one need not take a static view of this matter. The size of the Plan, moreover, depends also on the price factor. A Plan becomes "large" simply by inflation. Therefore, the kind of prestige value that is attached to a large Plan is something that seems to me to be irrational.

And yet for years together, I am afraid, in our country, the size of the Plan has become a matter of doctrine and ideology. If we advocate a small Plan well within our means, we are dubbed "reactionary" and if you plump for a big Plan, you are a "progressive"—irrespective of whether these targets are achieved or not and whether you visualize resources that are necessary for this purpose. My contention today would, therefore, be what is important is not the size or the magnitude of the Plan but its content and its achievements. Moreover, judging a Plan simply by financial targets or magnitude is not an adequate test. Whether its fiscal targets—in terms of expenditure—have been achieved is not so important as whether in concrete terms, that is, in respect of social welfare, economic growth, there has been definite achievement. We find in many spheres that expenditures may have been 90 per cent but the results have been only 60 per cent. Because of neglect of this basic element we have inflationary pressures on one side and foreign exchange crises every three or four years. Our Finance Ministers have to go abroad for seeking aid year after year which does not redound to our national prestige. Many people here feel that the World Bank has pressurized the Government of India. Believe me, the lender and donor countries feel that the Bank is pressurizing

them year after year and there is considerable disenchantment in these countries on the question of foreign aid. We seem to be having almost built-in foreign exchange crises, built-in deficit financing and inflation and consequent built-in disillusionment.

We are now living in a peculiarly transitional period in which we have no Plan at all—the Third Plan having ended on 31 March 1966 and the Fourth Plan not having begun yet. Which reminds one of Mathew Arnold's memorable observation of a world which is dead and another powerless to be born! Government and planners have rightly laid stress from the very start on growth and development as well as stability. We cannot have development without stability, at least not the kind of development we want nor can we have stability without at least minimum of development. But I suggest that today, we have to put emphasis on stability rather than on very rapid development. We should also lay stress on healthy development because without a stable medium of exchange, without a stable basis of our currency, we are building castles on sand. Lenin once said that the surest way to bring about a revolution is to debase the currency and make it worthless. We have to bear that in mind. We have been enamoured of what Professor Galbraith once called "symbolic modernism"—large and heavy projects, highly capital intensive with long gestation periods, low returns which are awfully exchange consuming. I am not against basic industries but I cannot help feeling that a proper balance has not been kept between heavy industries and industries or services which subserve the needs of the common people. Many huge public sectors have shown very low returns. But I would like to add that the private sector should bear this in mind and see that for the time being at any rate, they undertake those schemes which involve no expenditure of foreign exchange and utilize as much indigenous raw materials as possible and which can give immediate returns in terms of goods and services. This is one of the obligations of private enterprise today, because its duty is not exhausted merely by preaching to and criticising Government; it is also to discipline the commercial and industrial community and see that the crisis which faces us concerns not merely the Government but everyone of us in this country. For, while we may discuss depreciation allowances and development rebates,

there is tremendous social unrest in this country. Unless the price line is held and the cost of living does not go up, the country is going to be in an extremely grave position. One of the reasons for this unhappy predicament is that we have tried to do everything in one sweep, to cover the gaps in the industrial structure in one sweep, our defence needs in one sweep. In the 1963 budget, after the Chinese incursion, when there was additional defence expenditure, it need not have been covered in one stroke. All defence expenditure was not going to be incurred in one year. Consequently, some phasing could presumably have been done and if some phasing had been done in expenditure, some phasing could have been done in revenue also. We are all very unhappy, although we may express it in different ways, about our undue dependence on foreign aid. Let us face the fact that we are all responsible for it and if we had not been so fascinated by giant projects and in such haste to build a heavy superstructure on a stagnant economy caring neither for costs nor been so fascinated by giant projects and in such haste to build a heavy superstructure on a stagnant economy neither caring local costs nor for expenditure in foreign exchange, we would not have been in this plight. We did not try and live within our means. Lord Cromer, who recently retired as the Governor of the Bank of England, said 'prestige has to be earned and not bought, least of all on borrowed money'. The Finance Minister has rightly emphasized the vital importance of avoiding deficit financing. But control of prices requires concerted endeavour of Government, industry, the trading community and consumers. The tendency to pass on all costs to the consumers is only equal to Government's tendency to look for more and more taxation to cover its deficits. Government are anxious to prevent inflation, but Government's own policy has not always been brightly anti-inflationary. The objective has been more often to raise resources without adequate attention to the effects of its measures on production and economic growth. And I might add that when we speak about deficit financing it is not merely a question of balancing the budget but involves the whole problem of expenditure of Government. 'Economy', said Gladstone, 'is wise spending'. It is worthwhile examining whether Government could not peg their expenditure at the present level for the next two years or so. Chambers of Commerce have also

an important role to play at present. We have to concentrate more and more on resources being provided indigenously for our requirements and reducing our dependence on imports. It may be that for the time being, we may have to do with some shortages and second best things. Ours is a poor country. Our whole scale of priority needs to be changed. This does not mean a pause in planning or a holiday from planning. There cannot be a pause in investment in the country but we have to work on a much more selective basis. Let there be no illusions. Devaluation is bound to be a painful process. We are in a very difficult period. Above anything, we need discipline, a national discipline which both Government, industry, business and the whole community has to observe.

SHRI C. H. BHABHA

Since an elaborate statement has been made by my predecessor. Shri G. L. Mehta, I shall only touch upon two or three points which have attracted my attention. In the first place, I join hands entirely with what my predecessor has said regarding planning in this country. It is a fashion to talk in terms of planning. All of us have been accustomed to planning. We do have planning for our homes; we do have planning in our business; and one need not be an economist to think in terms of planning exclusively. As a friend of mine told me somewhere abroad about our late lamented and worthy Prime Minister, Shri Jawaharlal Nehru, that his thinking of planning is that of a 'school boy in a hurry'. I think there is a lot to ponder about this remark. Before we have grown up, we have thought in terms of running too fast and presenting large figures to the rest of the world. This has brought us to the present state of our economy. I for one would like to suggest that we should now think in terms of a plan with the minimum of foreign exchange content, what one should call a 'Swadeshi' Plan, a 'zero' foreign-exchange-content plan. Such a plan too should aim at something more realistic than what we have done with cutting down of wastages. To give you one instance, the Planning Commission, which was started as a really small, compact and effective body, given to constructive thinking, of about 200 people with a budget of Rs. 6-7 lakhs has

today grown into a vast organization employing something like 1,200 to 1,500 people and costing the nation a little over Rs. 1 crore per year. The next point I would like to make out is that in the context of heavy deficit financing in the Second Plan, we were told that it would not be more than Rs. 550 crores during the Third Plan and that it would be justified by the increase of national income of the gross product. But what is the situation today? Instead of Rs. 550 crores of deficit financing, we are overnight faced with a deficit financing of Rs. 1,500 crores and that is the biggest curse which needs to be condemned in the strongest terms. One factor in the context of deficit financing, to which I would draw your attention, is the growing tendency on the part of State Governments and semi-Government bodies to overdraw heavily and avail of unwarranted credits—a tendency which unfortunately even the highest financial authority in the country is either not willing or not in a position to curb effectively. The consequence of such deficit financing has been that the so-called market borrowing of some of the State Governments without credit causes their own securities overnight to be quoted at a terrific discount. You create an atmosphere of unreality; the money that you are supposed to have taken is not there in actual practice. Of course, recently they have set up a little "cell" to examine to what extent these so-called issues of public loans have really brought in the money; whether in the first place money has come in, and if money has come in, for what purpose the money has been used. That is the basis of the situation which we see today and which we call inflation. So my point arising out of this, is that from time to time we should be frank and forthright to tell those in charge of our finances that they are trying to perpetuate throwing on the shoulders of this nation a burden which is unproductive. My predecessor called it non-Plan expenditure. I say it is a criminally wasteful expenditure. In the case of public enterprises, there is an artificial creation of money of Rs. 2,000 and odd crores. The addition to the national product has been quite insignificant. The last point is regarding the credit and monetary policy. I have got a reprint of the last Seminar. Unfortunately, I was in Delhi at that time and I could not be present. About credit the banking system is being condemned that it is not sufficiently liberal and it should have done this and that. Banking today is put in a strait-

jacket. Instead of telling us to be liberal, telling my friends in the banking world to be liberal, you should examine to what extent there has been a growth of genuine bank deposits and how from year to year banks' programmes, policies and demands go on expanding and how the ratios of loans to growth of deposits have been increasing. Deposits are funds which are expected to be most productively used. But it so happens that banks are sometimes compelled to utilize or divert some of these funds to unworthy channels which either misspend the funds or fail to keep up to their commitments to the financial institutions. Year after year, we have been asked to support certain projects sponsored through semi-Government institutions included in the Plan. We are supposed to finance them either by giving advance or subscribing for bonds which have to be carried for 15 years-bonds the money invested in which does not bring in any return or reward.

I am particularly sorry to say this about co-operatives because I have been recently studying "co-operation". One significant thing which attracted my attention is that the amount of money that is spent on the co-operative movement just prior to the election reaches its peak and then goes down. You know how much of the money in the co-operatives has to be written off in some of the States. Just before the elections, the graphs showing the extent of support which the Reserve Bank and banking organization give to co-operative financing institutions or co-operative banks, touch their peak. Further comment is superfluous.

Finally, I would like to say this. Devaluation offers us some breathing time for re-examining the whole philosophy of our economic planning. Let us hope that our planners will not let this opportunity slip by.

SHRI S. L. KIRLOSKAR

Devaluation is very much here now. While I had for some time been pleading for it, arguing compelling circumstances, it would be idle *now* to ask whether it was wise or unavoidable.

What is now urgent is the follow-up. Three months have elapsed since the rupee was devalued, without anything forth-

coming from the Government in a concrete shape. If the follow-up is delayed any longer, there is bound to be trouble ahead, even disaster.

I have a feeling that right within the Government, there is a fairly large section of officials which is aware of what must be done to make devaluation both viable and effective. But I also feel that there is another section of officials which is pulling the other way. The result is the present economic stalemate.

All of us know that in war, when a major battle goes wrong, they change the generals, especially when it becomes obvious that the battle was lost due to avoidable errors on the part of the generals. I think the rupee devaluation is a major economic battle lost, and its blame must rest squarely on the group of technical and economic advisers—in the Government, in the Planning Commission, and in the non-government private institutions which advised the Government.

Unfortunately those who made devaluation inevitable due to their economic policies are also the persons who are called upon to dream up and execute the follow-up. This, I strongly feel, is a grave error. For it amounts to expecting this group of officials to shed its old ideology and economic thinking and to adapt it to the new conditions and needs created by the rupee devaluation. This just cannot happen. I therefore strongly plead for the central administration being infused with new blood and therefore staffed by new people.

My second point concerns a certain confusion in many minds regarding a deficit budget *vs.* a balanced budget. It is too often thought that a simple arithmetic balance will solve our problem. I do not think this would be enough. Let me illustrate. At present the Government is laying out vast sums of money on co-operation, unproductive projects, an overblown civil service and on expanding ministries. If it raises the required money by an additional tax effort, it can still claim to have balanced its budget. But would that be a healthy balance? All that is happening is that the tax-payers' money is being used up to maintain a vast, unproductive complex—there is no net addition to our national wealth or assets.

In economic textbooks, they usually distinguish between a national budget and that of a private individual. In the former, revenue is to be manipulated to suit the estimated expenditure.

In the latter, the individual must cut his coat according to his cloth. I think it was time our Government behaved more like a private person than like a government. It must begin by laying the axe on its expenditure. And when I say this, I have in mind not only the Central Government, but all public authorities right down to the level of the village panchayat. The greater part of the tax-payers' money spent by and for these various public authorities is wasteful, and unproductive. If public outlays are cut to size, there will be no need for heavy taxation. It can be brought down.

This brings up another fallacy which seems to rule many minds. It is thought that the sum total of taxes collected from the people every year is the same as our total national savings. Now there is doubtless the need for increasing our savings. But there is a vast and *proven* difference between savings as utilized by the Government and those used by private persons like, say, me. The former do not result in the production of useful national capital; they are a waste. By and large this cannot be said of the use of savings by private entrepreneurs. The latter cannot afford, in their own interests and in the interest of their shareholders to whom they are accountable, to misallocate them.

This brings me to my last point.

Devaluation has, above all else, been the result of monetary indiscipline. A major factor contributing to this indiscipline was nationalization of the Reserve Bank of India! And I do not mean just formal, statutory nationalization. I rather mean the loss of its autonomy, its freedom to steer the monetary and credit affairs in the country in the light of *its own* reading of the economic situation, without being troubled or pressurized by the Treasury or by leading groups in the State Governments. It is distressing to think of the Chief Executive of the Reserve Bank often being unable to resist impossible demands from the Central or State Governments. Thus we have a very interesting situation—on the one hand the RBI puts a squeeze on credit, while on the other, it prints more money for the Government than before the squeeze!

I strongly plead that our central monetary authority is restored to a position where its chief executive can boldly tell his clients—whether government or private—when they can be accommodated and when they cannot.

Shri P. L. Tandon

I am concerned with three things. The first, I do not think we have quite recognized the interesting new phenomenon which devaluation has brought in, and that is that the speed with which the economy will move up or down will be much faster than it has been in the past. Prices can move much faster, equally national income can move much faster, both up or down. I will illustrate this point by the simple fact that there was a price rise last year of 15 per cent; and yet look at the way prices initially moved up after devaluation!

In the first four years of the Third Plan our total rise in national income was around 17 per cent and in the last year there was a fall of about 5 per cent; population-corrected, therefore, there was no rise in national income from the year 1960-61 to 1965-66. Unless we are careful our economy can run down even faster in future. We should take advantage of devaluation to accelerate our progress rather than to decelerate it.

My second point is that devaluation was somewhat unfortunate in its timing. It came at the end of a very poor crop year and a year in which there had been a record rise in prices. I would suggest that two things are now necessary: one, the long-term solution, which was very ably brought out both by Mr Mehta and Mr Bhabha, was about deficit financing, co-operative credit, public sector, and so on. Second, some immediate solutions to look after the next three to six months. In the next six months we should call a moratorium on things like deficit financing and over-spending, which I am sure Government is very conscious of, even though it has its own problems.

I would go further and suggest that our immediate attention is required in four areas: *(i)* production, *(ii)* imports, *(iii)* exports, and *(iv)* a prices, wages and incomes policy. I think if we can tie up these points better than we have done in the past, we have a good future. I know Government is trying to do what it can, but on imports, for instance, there has been over-licensing in some industries, under-licensing in others and no licensing in yet others, and in exports there is a standstill. We have to get out of this position as quickly as possible.

My submission to you, Mr President, would be that this is not the time to talk too much of long-term solutions. Would you

suggest to Government to constitute an informal group of ten people, five senior secretaries and five members from industry, who should meet every month just to examine these four question—imports, exports, production and prices, wages and incomes. It may, if necessary, suggest strong measures such as the British Government is trying to undertake. Thus, without making any profound contribution, I would submit to you that let us concentrate as quickly as we can on these four areas; otherwise if the price rise continues and imports are imbalanced, production does not revive at the rate we would like and exports do not pick up soon, we would have some more problems on hand.

SHRI NAVAL H. TATA

It is in fitness of things, that the President, as the host should be extending a vote of thanks to our chief guest, who has been kind enough to come and offer his views to us on a momentous question which is agitating the minds of the entire country in general and the business community in particular. We have noted, with great respect, all that you (the Governor of Reserve Bank) have said. However, that does not complete the picture of the problems facing the country. Though two months have passed, no particular decision of consequence has been taken. I would compare and contrast the attitude of other countries which had to face similar kind of ordeal. I cannot help feeling that they had prepared themselves far better for such disasters than what we have been able to do so, either before or after the event. I have seen in a press report, a programme which the UK Government has prepared even before they have resorted to devaluation, setting out in detail what they are going to do. If you go through the list you will notice that the decisions affect all sections of society, in a bold-hearted manner ahead of time, and not wait and watch till the event took place and then start taking stock of what has happened.

Unfortunately, the debate which has taken place, on the subject in Parliament, has degenerated into a political debate where ideologies of West and East have been dragged into the picture. One gets an impression that there is a kind of *post-mortem* going on as to why devaluation was resorted to and who was res-

ponsible for it, rather than what we should do about it. Shri Bhattacharyya has been kind enough to give us a detailed survey of the financial situation and has given us a lot of advice. Quite a number of these, we quite agree, and we should carry out in order to fulfil the task of enabling this country to face the challenge posed by devaluation. But what we do find is that the sacrifices which have to come from all sections of society and not only from business community, have not been spelt out to a degree it should be.

I have just returned from a Labour Conference. There we were pointing out to our worker friends how the Government of UK, a Labour Government, had the courage of conviction in suggesting a wage freeze. In contrast, our Ministers are today talking endlessly and declaring that they do not agree to a wage freeze in our country. Yet when it comes to dearness allowance in the matter of the State and public employees, they have no compunction in indulging in a wage freeze. Unless sacrifices emanate from all sections we do not understand how this country will be able to face the challenge and ensure that costs are kept low and the productivity maintained at a high pitch. With great respect to our Chief Guest, I wish to point out that there seems to be an atmosphere of inaction and inactivity. If anything, there is an incitement to inflation. It was an amazing feature to notice that with the immediate announcement of devaluation, even in the Government sector, say the Asoka Hotel, the I.A.C., there has been a price boost. Wheat prices in Maharashtra were raised and cotton ceiling was revised upward. What I say is that, at this particular explosive moment, things like this should not have happened. Instead of checking prices in order to hold the price line we find in Ahmedabad, dearness allowance is allowed to go merrily on to a pre-determined formulae to a dizzy level of Rs. 150 when the local Government are talking in terms of finding resources to meet the challenge of increased dearness allowance in the public sector. It is difficult to understand the policy of Government in holding the price line, when *ad interim* awards, in Engineerig Industry, by the Labour Tribunals, are blessed with increase in wages. In a Seminar like this, we should come to certain very broad principles and decisions and we should be able to guide and give Government some idea as to how we should meet the challenge of devaluation. It is a pity

that our chief guest was not a witness to an interesting discussion we had before he came to the meeting. Some constructive views were expressed by Shri G. L. Mehta, Shri Bhabha and Shri Tandon on measures which could counteract the adverse effect of devaluation, and impart stability to the economy. One of the views expressed was that the Planning Commission should not go on a five-year basis but should have surveys of shorter period and review quickly the resources and then concentrate on an entirely self-reliant programme with emphasis on agriculture. We might adopt what Shri Bhabha suggested: a Plan which concentrates upon indigenous materials and less dependent on foreign imports, of a modest size, which could do the trick in ensuring definite results. It may be necessary to resort to a wage, price dividend freeze. We may have to think in terms of price control, and a tighter control on all forms of expenditure. Unless there is control on expenditure, we will not be able to hold the price line and, to that extent, all our efforts which we are making today will be absolutely negatived. I also feel that a High Power Committee of the type, which was suggested by Shri Tandon, say with eight to ten people representing four parties concerned viz., Government, industrialists, workers and consumers, should get together and tackle the problem. What we feel is that we should overcome inaction and inactivity on the part of the Government in order to grapple with an unusually difficult problem. In closing, I once again like to thank you, Shri Bhattacharyya, on behalf of the Indian Merchants' Chamber for sparing your time and coming here to give us the benefit of your views.

Shri Babubhai M. Chinai

Devaluation is a subject hotly discussed for the last two months. As a businessman, I would like to put forward some suggestions for follow-up action before this House. Before I make any suggestions, I would like to give a little background of the whole situation. Even though it may be termed as a *post-mortem*, I think, it would be necessary to make a few observations. It has been said that we have done devaluation under pressure. The Government's spokesmen have been denying this

emphatically. But one thing is certain that, under the pressure of International Monetary Fund and the World Bank, we were put to only one choice and that was whether we want aid or we want devaluation. If we wanted aid, there was no other alternative but to devalue, and we, in our wisdom, decided that we should have aid and therefore have also devaluation. Now, having devalued the rupee, I wish the Government, side by side, even if it was a delay of a week or fortnight, should have come forth with all the corrective steps which they wanted along with devaluation. They claimed that the devaluation decision of the Government has been kept a very well-guarded secret. But along with devaluation decision, they have also kept the corrective steps a very well-guarded secret. In spite of the fact that devaluation has taken place with the exception of the announcement of liberalization of imports in the case of certain priority industries during the last two months, no other corrective steps have been taken. So far as the priority industries list is concerned, besides 59 industries, there are several others which can be entered into this list.

As far as the liberalization of imports is concerned, you know that due to the pressure of some of us, Government have started telling us that they have issued licences for Rs. 100 crores and then they said they have issued licences for Rs. 125 crores. But they have forgotten that two valuable months have been lost, by the time the credit is opened, goods are negotiated and by the time they are received into this country, at least another two months will pass and, therefore, four very valuable months would have been lost. The other side is about exports. Since they have announced the decision of devaluation, certain export duties have been levied. Later on, they reduced some export duties and also removed a few of them. This has been going on all along with the result that exports are at a standstill.

Now, 'what next?' is the question. I want to convey to this Seminar that we must emphatically recommend that deficit financing must be completely eliminated. Most of the troubles, according to me, namely, the rise in prices and subsequent evils arising out of devaluation, are due to the deficit financing. We have allowed the States to spend as much as they liked without restricting them but giving them printed notes every week. You know that from the platform of this Chamber we have been

stressing again and again that deficit financing is an evil. The Finance Minister has now come out during the last fortnight saying that we shall not have deficit financing. In spite of his saying that there will be no deficit financing, I find that deficit financing is still going on. That is the main crux of the whole problem.

The second point relates to the measures which Government should take in order that we may increase production. Now, so far as more production is concerned, no doubt, raw materials are being given, but there should be continuity. Not only continuity but the manufacturers must be assured that whatever has been given is not for six months or for twelve months, but in the coming five years of the Plan so that they can plan their production. If that is not done, at every stage, there will be some difficulty. I want to refer to another problem in this connection. This is concerned with finance. We had a Conference recently with the Governor of Reserve Bank. On one side, the Reserve Bank Governor said that there was no question of any further credit release or cost of credit being reduced, because the very fact of devaluation was a disinflationary measure. If that was so, on the other side, the Food Minister, on that very day from Madras said that the Government has taken a decision and were going to relax the credit squeeze. If these two things were heard by the same person there would be confusion. This Conference must say to the Government that whosoever is concerned with the subject, should finally speak and none else.

Another point I would like to stress is controls. I am one of those who believe that controls, to an extent, are absolutely necessary. There are, however, very many irksome controls which only satisfy the bureaucrat. Recently, we had a Seminar on Controls. What I wish to point out is that you must just try to ask every industry as to what are the controls on which they feel very sore about it, and which can be easily removed. I am told that in the textile industry, they are required to fill in 325 forms. Is it not possible to consolidate and reduce them to 6 to 7 forms? Let us see Capital Issues Control. Capital Issues Control was formely for Rs. 10 lakhs, it was raised to Rs. 25 lakhs and then once again to Rs. 40 lakhs. But the decision has not been implemented by the Government. The Control on Capital Issues beyond Rs. 1 crore should be removed. To start with, they can start Control at Rs. 50 lakhs and later on it should be raised to

Rs. 1 crore. Unless steps are taken to relax or remove irksome controls, the economy wil never improve.

SHRI R. G. SARAIYA

You have given a comprehensive and at the same time practical statement of the problems posed by devaluation.

In the first place, I agree with you that we have to accept devaluation as a *fait accompli* and it is no use going behind the reasons for the devaluation. However, it is necessary that we should examine the background or the forces which compelled the Government of India to devalue the rupee in order to try such steps as may be necessary to prevent a similar calamity in future. It is well known that many countries like France, Japan and Italy made a success of their economy after devaluation. There have been other countries where devaluation has been followed by further devaluation till the value of the currency was reduced to almost nothing. There is the classic example of the Mark under Hitler or of the Chinese economy before the Communists took it over and the recent developments in Indonesia. This is the time when the country should take stock of the position to ensure that we make a success of our economy and not follow the slippery path of inflation and devaluaation leading to further devaluation or worse. It would really mean further erosion, if not extinction, of savings of the people held in the form of currency or deposits, stagnation of the economy and the stifling of further growth for a long time to come. I am quite sure that the authorities and the business community are quite alive to these problems. It is also necessary to educate the people—the masses of India—on these problems. The country as a whole cannot live or spend beyond its means. People are asked what they want, their needs are pooled together and promises given. These promises are then translated into large plans which are not fulfilled. India is gifted with sufficient talent and natural resources to be able to give a good account of itself. Shall we have the courage and the organizing ability to put forward the efforts necessary and the sacrifices involved in steering our economy through to what is called a self-generating economy?

In this process much has been said about the question of holding the price line. With a determined effort, the price line can be held in respect of articles of internal production; but the country must face the fact that devaluation will imply an increase of cost by 57½ per cent for a number of imported articles except to the extent to which these imported articles were sold at prices in the form of import licences. To the extent to which we have to pay an increased price in rupees for imports, the country must reconcile to higher prices of articles and goods imported or having an import content. But there can be no absolute holding of the price line and it would be incorrect to mislead the people into the belief that prices can be held absolutely and rigidly over the next year or two on all commodities and on all requirements. But imports are only a small percentage of the gross national product and the impact of such price rises would not be material, unless other inflationary forces are at work. But so much has been talked about the holding of the price line that I do not propose to develop this question further.

The main reason for devaluation was the inability of the country to export a volume of goods enough to pay for the import requirements, even for such necessities as food, defence requirements, mineral oils, raw materials like cotton, capital goods, spare parts, components, etc. With dwindling foreign balances and rising import bill, the rupee became very vulnerable and the main object of devaluation is to enable the economy to divert its resources to exports to an extent which would enable the country to pay its own way with decreasing amount of foreign aid from year to year. In this context, exports are a must. To the extent to which our exports become competitive by devaluation and price reductions in terms of foreign currency, no further assistance for exports may be necessary. But there are a large number of industries where in spite of the devaluation, exports are not possible because they are unable to get import licences for some of the essential raw materials, spare parts or components. Government have recently announced that in respect of 59 industries, imports of spare parts, raw materials and components will be allowed freely. The question is whether these imports will be sufficient to enable the industries to keep up full production both for the goods exported and also for

the goods manufactured for internal consumption in which also will enter some imported raw materials or components. Then there are industries outside the 59 industries and industrial concerns which are not fully covered by the description of the 59 industries announced by the Government of India, which also have to play their part in supplying goods to the people, in maintaning exports and in maintaining the industrial complex of the country as a whole. There should be some machinery by which these industries are able to earn through exports incentives for the import of raw materials, components, spares and other things which are required for their successful running. There has been no announcement in regard to this so far, although we were expecting some announcement by the end of last month. I would like to urge that Government should examine the case of each industry and each Export Promotion Council and come to a decision in regard to what imports will be allowed to them in order to enable them to function and play their proper role in the Indian economy. In my capacity as Honorary Export Promotion Adviser to the Government of India, I sent circulars to the Export Promotion Councils and many of them have responded with their difficulties. The Engineering Export Promotion Council is represented in this Seminar by Dr Bhoota. I have also heard from the Cotton Textiles Export Promotion Council, Basic Chemicals, Pharmaceuticals & Soaps Export Promotion Council and Woollen Export Promotion Council. All these industries are handicapped and would not be able to play their proper role in fulfilling their export targets without being assured of some imports. This is not a place to enter into detail, but it is necessary that a practical across-the-table examination is made of the problems of these industries and others. With faith and trust on both sides, a policy will have to be evolved within the resources available to the extent to which it has been assured.

Then there are the practical problems of tea, jute and other industries where the additional value of devaluation has been denied to them by the imposition of export duties. The tea industry has already protested to the imposition of export duty at Rs. 2 per kg. which impinges more heavily on the cheaper varieties of tea which are naturally lower in price. In the case of jute industry, to the extent to which it imports its raw mate-

rials, the benefit by devaluation has been reduced and some adjustment will have to be made in respect of assuring it its supply of raw materials as well as the full benefit of devaluation to enable its exports to flow more freely (a subsidy on imports of jutes has since been announced). If exports are a *must*, they should not be handicapped by export duties, and a quick and flexible policy of adjusting export duties should be evolved, so as to ensure a smooth maximum flow of export.

Indian cotton is now cheaper and to the extent to which textiles made out of Indian cotton can be exported, they should fare better. But to the extent to which India is exporting sophisticated goods and fine and superfine textiles made out of imported cotton, the Government will have to take a decision as to whether it wants to encourage the export of textiles made out of imported cotton and at least the handicaps on imported cotton should be removed.

I started by referring to the question of holding the price line. It is well known that a large number of industries have contracted to import and install machinery on deferred payment basis. They will have to pay higher prices for their imports of machinery in order to meet their instalments dut on deferred payment basis. Then there are industries which have already imported the machinery and installed it. They will have to make deferred payments and the question will arise for accounting for the extra capital and interest payment that they will be called upon to make as a result of devaluation. They should at least be permitted to write up the value of their machinery to the extent of this rise in cost due to deferred payment of instalments and interest at the devalued rates. Apart from this, there is the question of finding the extra money in respect of the industries which were established or which have entered into agreement for the import of machinery, know-how, etc., under deferred payment terms. They will require more finance and it is up to the financial institutions of the country to see that such finance is made available to them at reasonable rates. Ultimately there is no gainsaying that the cost of this extra finance will have to come from the product sold and to that extent the price which will be charged by these industries will be raised, but it is necessary that no financial crisis is brought about in this country and bona fide industries which have entered into commitments for

the import of machinery, know-how, etc., are enabled to meet their requirements.

One point which must be stressed is that agriculture must receive highest priority so as to avoid our dependence on imported food. Our mineral resources which have not been developed often as a result of a dichotomy between the private sector and the public sector should be developed. You, Sir, have touched upon these problems. These, to my mind, constitute the greatest challenge to the economy of the country. Then there is the question of the workers and their political leaders. Who will tell them that morchas and slogans will not produce one ounce of rice, one blade of grass or one yard of cloth? In solving our problems there should be a continuous dialogue and understanding between the Government and the Planning Commission on the one hand and entrepreneurs in the private or the public sectors whose job is to produce goods which are required by the country both for export and import. Ours is a great country which is rich in human talent and in natural resources. Shall we have the organization and the unity to meet the challenge posed by devaluation?

Shri E. P. W. Da Costa

I am aware I am expected to speak as an economist but having heard the views already expressed, I venture to submit, as far as the Seminar is concerned, it would be much more advantageous for my contribution to concentrate on the lack of communication between Bombay and Delhi. These are, so to speak, the centres of private and public sector philosophy. There are basic differences in approach which to my mind make many of our recommendations impracticable. The more I come to Bombay and, I come frequently now, I really feel that there is some great difference in thinking. Take the excellent point made by Shri Tandon. He stressed the need for an objective "here and now" approach and the possibility of an agreed policy in production, exports, imports and prices which would be free from controversy. This looks plausible, but it is not so at all because all these policies are affected by the size of the Plan. It may look convenient to assume a Plan which does not enter into the

picture with production, import, export and prices. But if you have an inflationary plan, it is going to affect prices, it will affect exports, it will affect production, it will affect incentives and so on. Take another instance of devaluation, and the use of existing capacity by liberalized imports. The World Bank and we have very clearly in mind the point which everyone in the private sector understood, though no one expressed it bluntly, that unutilised capacity is mainly in the private sector and, therefore, public sector projects with assistance from "project" aid with long gestation periods should be put automatically into cold storage. This has obvious consequences in political terms for it involves a change in emphasis in the socialistic pattern of society and hence conflicts with Delhi's political dogmas.

For the public sector has little unutilised capacity. Its great investment in steel is largely utilised. In other areas it had little spare capacity; but this was clearly a change in policy. Thus the private sector was intended to be favoured under the new dispensation. This is obviously a great political obstacle. The Prime Minister of India, sitting in the Planning Commission last week said that "I refuse absolutely to accept the proposition that we depart from the project approach." In her "person to person" broadcast she virtually declined to accept the perils of inflation. If the Prime Minister is going to act on a Plan, as she seems determined to do with a minimum of Rs. 16000 crores in the public sector and Rs. 7700 crores in the private sector, we will have an inflationary effect of perhaps 10 per cent per year. How then can we find agreement with the Government?

To preserve the balance, let me present the other side also. We all, almost every member of this house including myself, supported the Second Plan and Third Plan deficit financing and all. The Indian Merchants Chamber, as Mr Babubhai said, may be an exception. I remember, however, the Federation of Indian Chambers of Commerce and Industry, throughout the periods of 1955 to 1961, was supporting what was definitely inflationary finance. I remember being told years ago by many businessmen, who are today saying that deficit financing is wicked, that the latter was much preferable to taxation. If you say, we did not stand for a Big plan, we did not accept the deficit financing as a means to develop markets, you are saying something which will further reduce our capacity to talk to Delhi for we would

be saying something not true. For the business community I would deprecate a sudden change of attitude towards past mistakes. In any case this is not easy for a Government which has to face elections early next year. They have not a similar degree of freedom. And they have, therefore, a major hurdle which Bombay does not appreciate.

If we are to be effective in Delhi we must recognize that we have been at least in part agreement with some erroneous policies and we have made similar errors. I would ask that when making our submissions to Government, we keep the records straight and recognize practically the whole business community opted for deficit financing and an inflationary Second Plan and up to 1962 also in the Third Plan. The business community also overrated and overused foreign collaboration, it overimported and benefited in the process. Let us be a little more constructive than we have been today. I make one or two suggestions. First of all, we should frame an alternative Plan. I thought of this and took the precaution of writing out my own ideas on the subject. I am taking leave to circulate two or three documents here in the hope that they might be of some assistance in framing what we might consider a truly non-inflationary Plan.

Secondly, we have to recognize that the Plan has two aspects—one is price stability but we must also ensure a growth rate of 5 to 6 per cent. Production is one side to counter inflation. The other side of inflation is money. We have had the Governor of the Reserve Bank today. It is perfectly clear that if lessons of the past have any relevance, no new money can be created suddenly without new inflationary pressures. But if you say no deficit financing and price stability, what you are saying to the Governor of the Reserve Bank is not to increase advances. Yet we are asking at once for a liberalization of credit. Most of the money has to be created in the first instance. Whether it is created in the form of bank advances, by liberalizing Reserve Bank's orders, or whether it is done by deficit financing, it is inflationary. Let us stop doubletalk. We need money for productive purposes: deficit financing may, therefore, be necessary. Why should we deny it a limited role?

Apart from the past, let us have a Plan which is "realistic". But the word "realistic" means different thinking in Bombay and Delhi, because in Delhi "realistic" means an acceptable dialogue

with the people at large. Here "realistic" means conservatism in terms of balance sheets and resources means money. In Delhi it includes large intangible, undefined, but nevertheless, important political components of living in this country. If you say be realistic, let us spell it out. If you say no deficit financing, let us spell what this means. If you say no more bank advances, let us spell out that too. Again, take taxation. We have a good reason for cutting taxation. But if, as Mr Saraiya said, you say cut export duties, then you must leave out import subsidies on food and petroleum products; otherwise, you will have deficit financing. The revenue from import-export duties would be Rs. 120 to Rs. 160 crores. You cannot have it both the ways.

I think the dialogue between the business community and the Government must be in terms of recognition that we face devaluation as one nation. We are equally responsible with the Government for all the mistakes that have been made and we should be equally responsible with constructive proposals acceptable to the country as a whole. For only so can Indian democracy become a living thing and we all stand or fall together on its success.

Shri Kamalnayan Bajaj

I generally agree that a *post-mortem* should not be done with a view merely to critize. But unless we analyze the problem in order to understand it in the proper context, I do not think we can do full justice to it. The Finance Minister has said that devaluation has been accepted as the "lesser of two evils" and is "not an unmixed blessing". The Prime Minister has said that it is not a happy choice. Can we really build our nation by accepting even a lesser evil without a positive and constructive approach? Even if devaluation is a wrong decision, I will not be afraid of it, provided it is done with the best of intentions. But even the right thing has to be done in the right spirit with full confidence in it, because when we do something with helplessness it becomes difficult to handle the whole situation.

The examples of France, Britain and Yugoslavia are pointed out in support of devaluation. They had devalued their currencies at different stages. But did they do it as a negative

measure or as a positive measure in the economic context of their countries at that time? They did it because they had surplus goods which they could not export and also had immense potentialities to produce more, and they could export these goods only by bringing down prices through devaluation. If we have the same factors in our country, we too would be justified in doing it.

Another thing which has been dealt with here but not fully is our debt to foreign countries in foreign currencies. I think Mr Da Costa will be able to tell you the exact figures. The foreign debt has overnight increased by 57.5 per cent. The general answer given is that we are not going to repay it in money but in goods. If we are to repay in goods, probably devaluation would not affect it, except marginally because of the fluctuations in international prices. But have we really got the goods to pay back? If not, a major factor has been left out of consideration before devaluation was made.

The I.M.F. and World Bank gave general advice suggesting a particular course of action. It was for us either to choose or reject the advice. While accepting the advice the Government should have given some thought whether it would be possible to restore the value of the rupee in course of time. I think the business community should seek an assurance that steps will be taken to restore the value of the rupee in due course.

The private sector has to pay large amounts for goods imported on deferred payments. Overnight, our liability in respect of this has been increased by 57.5 per cent. The F.I.C.C.I. has suggested to the Government that the loss should be compensated by allowing development rebate and depreciation on this increase in liability. This may be a via media although it will not fully compensate for the losses. But is it really enough, especially in the case of industries which have not been making profits for no fault of theirs? In the long run they may be compensated by the extra development rebate and depreciation allowed, but what about their immediate need for extra finance required for repayments? You may say that the banks will finance them. But the banks are already in a tight corner. Even if they can finance, they will need extra security which is not there because most of the industries have pledged their assets to the fullest extent. As the extra liability has arisen because of Government's decision

to devalue, it is the responsibility of the Government to make good the amounts. I would therefore suggest that the Government should authorize the credit institutions to debit these amounts to its account. This will be a just and fair method to meet the difficulty and in the long run the Government would not lose more than what it would have done by allowing depreciation and development rebate. The procedure also would be simple. Otherwise, the industries will find it very difficult and especially some of the losing concerns, which may have prospects of making profits after two or three years, will be seriously affected. Production also will be hampered in many cases.

Regarding foreign aid for the Fourth Five-Year Plan, if some countries are sympathetic and friendly to us and able to assist, then alone we must accept their assistance. Let us not jeopardize the entire economic development of our country because of too much dependence on foreign aid. When the Fourth Plan was being formulated I suggested to the Prime Minister that it would be desirable to divide the Plan into two parts: one part should be based entirely on our own resources and should be implemented in full; the other part should comprise schemes dependent partly or wholly on foreign assistance which could be implemented as and when such resources are available. Provision should be made that our liability to repay the loans on such projects will accrue only after the promised aid is given in full and not withheld for any reason whatsoever. If this is done, I think most of the confusion will be removed. I am not worried about what is the size of the Fourth Plan. It will be based on the resources we can muster and the physical targets that we can achieve from them.

Another thing, which nobody has touched here, is the urgency of stepping up production. In order to produce more we must stimulate savings and their investment in productive enterprises. For increasing savings, the incidence of taxation must be reduced in a planned manner, but with increased production and turnover the total revenues will be augmented. Unless fiscal measures are taken in right earnest, I am sure, whatever abilities and resources are there in the country will stagnate and will not be properly utilized or exploited for the development and economic growth of the country.

It has been said here by our friend Mr Da Costa, in a diffe-

rent way, that deficit financing is bad. He blamed us that we are saying that there should be no deficit financing and in the same breath we ask for more money. I would say that I am not against deficit financing as such. I would like as much deficit financing as possible *but with one condition.* All the created money should be utilized for productive purposes with minimum of wastage. We say that there should be no deficit financing because we see the result of it in the public sector, where the investments are not all productive in this sense. It is harmful that such a large investment is not productive. But if you give the finance that is required by the private sector definitely we shall utilize it with 100 per cent efficiency, and by and large it will be more productive than the public sector has been.

I would like to mention a word about wasteful expenditure. Whether you print notes, borrow or beg to get money, and utilize it wastefully, inflation is bound to occur with all its resultant evils. Unless some bold steps are taken you cannot avoid a catastrophe. Hence wasteful expenditure has to be cut ruthlessly and non-productive investment must be stopped comppletely; with regard to whatever investment has been made already efficiency should be improved and productivity stepped up. Once this is done, deficit financing will not be harmful whether you utilize it in the private sector or in the public sector, which after all jointly comprise the national sector.

The bureaucratic structure at present, as it is, has hardly any knowledge and experience to handle industry. If a call is made by the Prime Minister to businessmen to offer their services for running public sector undertakings many will come forward to take up the responsibility. If business groups are given a few public sector concerns to manage, will they not do it for the sake of the country? Are they all so selfish?

While I was talking to the Prime Minister, she asked me a question about the Departmental Stores, I said I welcome the Departmental Stores and Super Markets for the convenience they would provide. Our ladies would like to go to one place and get everything from there, if possible. From this point of view, I entirely agree that such a thing would be useful, whether in the public sector or in the private sector. But if you want to hold the price line, this is no answer. Prices are mainly regulated by the law of supply and demand, and controls can be useful in

holding the price line when goods are in short supply only to a limited extent. Either you have to curtail demand by privation and sacrifice or you have to produce more. If there are no goods, there is no magic by which super-markets will be able to solve the problem of production. Besides, the idea of setting up super-markets is based on the view that businessmen are dishonest and corrupt. Even presuming that they are so, do you have a guarantee that the bureaucrats are honest and not corrupt? Moreover, they are less efficient. Ultimately, the cost of their inefficiency and top-heavy administrative set-up will be passed on to people by subsidizing the prices from revenues.

Further, the expenditure on welfare activities must be curtailed substantially. The point is how far the country can sustain such things at the present juncture. It is very good to talk about the standard of living. The question at present is of *living* and not of *living standards*.

During a debate in the Lok Sabha, one of our prominent ex-Ministers on the Congress side, demanded devaluation of the dollar, and there was loud applause from the Opposition benches, especially the Communist members. Can we really devalue the dollar? The only way to do this is to over-value our currency by which the dollar and all other currencies in the world will be devalued in relation to our currency. It is surprising that such suggestions are made lightly.

There is a small point, which is of great psychological importance, apart from convenience to the trade and the public in general. I have not been able to understand why we have devalued the rupee by 57.5 per cent and not by say 50 per cent. I have not been able to get a satisfactory answer to this from anybody. To my mind, this has been done presumably to arrive at a round figure relationship with the dollar. Otherwise, we could have devalued by 7.5 per cent and at the same time arrived at a round figure relation of a rupee to a shilling or 20 rupees to a pound sterling. We have destroyed this round figure relation with sterling area without calculating the harm and inconvenience it will cause to innumerable people including Indian settlers abroad on account of the very large number of transactions which take place with these areas. This seems to have been done just because of a prestige issue to please dollar gods.

Now that devaluation has been made with the set purpose of

improving our economy, measures must be taken in a planned way to achieve our targets, and in course of time to restore the prestige and value of the rupee by stages. If this is not done, the people responsible for implementing the projects must be taken to task as we do in the private sector.

Normally our imports exceed our exports by about Rs. 300 crores per annum, but because of the Pakistani aggression and other things, the difference increased by Rs. 200 crores. On the insistence of the aid-giving countries and international credit institutions we had to devalue the rupee. During my discussion with the Prime Minister, I asked whether after accepting devaluation we can do without privation and sacrifices? If not, why did we not call upon the nation to suffer privation and undergo sacrifices even without aid? If we had done so, our prestige in the world would have been enhanced, our country would have gained self-confidence and our people would have felt proud about it.

Unfortunately, after freedom, the national leaders did not keep alive the spirit of Swadeshi and as Gandhiji had said: 'We, the Congress people are to be blamed more for this.' The only other person who took interest in propagating Swadeshi even after freedom was the late Shri Pranlal Devkaran Nanjee, who had earlier taken the initiative in spreading the message of Swadeshi under the auspices of the Indian Merchants' Chamber, After he passed away the task fell on lesser shoulders like ours and we could not sustain the movement. But it is an opportune moment now to revive and revitalize the Swadeshi spirit. A call for this has been given by our Prime Minister and it is our duty to follow it up by taking to Swadeshi in right earnest, not only in consumer articles of daily use but also in machinery, spares, components and the like. We should not only propagate Swadeshi in a generalized manner, but should also take up article by article to spread their use. A Sub-committee can go into the question to devise ways and means for encouraging Swadeshi.

Dr B. V. Bhoota

Let me first thank you, on behalf of our Council, and also on

behalf of the two authors in the group for giving me this opportunity of talking at this Seminar about the export of engineering goods. I will certainly confine myself only to the export of engineering goods, because I know there are many experts here on other subjects and they have taken good care of the economic and other matters.

As far as the engineering goods exports are concerned, immediately after devaluation, we were asked to come to Delhi and just four days later, on June 9, we had a complete and detailed discussion with the Commerce Ministry and just 10 days later, I would like to make it clear, just 10 days later, we had given complete recommendations with full data running into 200 to 250 item-wise details needed in each case. In short, we made a very detailed study before we made our recommedations and I would like to share some of those with you here.

First of all, devaluation has certainly helped the engineering goods exports as it has helped other exports, in the sense that, we will be getting 57.5 per cent more than we did before. I would like to first list the positive side. The second thing is that because of the fuller utilization of the engineering capacities there certainly should be better distribution of the overheads which should result into the lowering of the prices but, as against that, there are many other items unfortunately in the negative side which do not make it possible, as yet, for the engineering goods to compete even after devaluation. I would like to list them very briefly. The first is that in the goods themselves we do find that there is import content of about 20 per cent to 50 per cent, so that the devaluation is nullified to that extent. The second thing is that they were giving steel and pig iron at concessional prices. We do not know whether these prices will still be allowed or not. If not, that will make a big dent in the help that the engineering goods were getting before. The third, of course, everybody else is having i.e., the increase in the other costs due to the imported items and on which still payments have to be made. The fourth, is that, there is the ever-present obnoxious rise in prices which may become the regular feature. It will thus take away part of the benefits. In the light of all these problems, we have studied and our Dr R. K. Singh, who is the Secretary of the Export Promotion Council, has given a lot of data as to the difference between the local prices and the

prices that we expect to get outside India. You will find that the differences are rather revealing.

I would not like to go into the details as to why our internal costs are high. But it is a fact of life today that the cost of engineering goods are much higher. Just as you see the air-conditioning units, you see the cars in the country. The other day, I was looking at the price of a vaccuum pump in this country because we are trying whether we can supply something from here to Ceylon. I was shocked to know that even with 57.5 per cent benefit the price of a vacuum pump in this country is about 78.5 per cent more than the price of a similar product in USA or Europe. These are the problems that we are faced with today in the engineering industry. However, I would now like to tell you that there is a fairly big scope if we really go about in the right way, for the engineering goods exports, in the sense that, as the Governor rightly said, out of Rs. 1,000 crores to Rs. 1,250 crores of engineering goods production in the country today, we are hardly exporting 2 to 3 per cent. As a matter of fact, we had the best production month just before the announcement was made. We were going at the rate of Rs. 2.7 crores per month, and if we had continued at this rate, I think we would have really made a dent in the non-traditional items. As far as I know the engineering goods, perhaps, are on the top of the list of the non-traditional items. Now we certainly feel that by the end of the Fourth Five-Year Plan, we should have easily reached a target of 100 crores which is about 10 per cent of the production in the country of the engineering goods. Some study needs to be made as to how this can be made.

Today, what we are exporting, are light engineering goods. We do find from a study of our Council that in many ways our economy would be comparable to that of Japan and if you study the export of engineering goods of Japan we find that as much as about 80 per cent of Japanese engineering goods exports are in terms of what we might call complete turnkey jobs. We, in our country are buying these projects. I am referring to the fertilizer plants, and to the alloy steel plant and so on. It should not be very far where we can really make an impact in these particular 'turnkey' jobs because in these jobs a lot of profit is in engineering, and this engineering, from what I know, we can do cheaper in this country for our draftsmen and engineers are

about as efficient as anybody overseas.

It is not the same story in our factory. Unfortunately, in our factory, for various reasons such as the size of the factory, high rates of labour employed etc., our productivity is rather low. We are not making use of the import substitution that is possible in this country. As a matter of fact, some time back many of you might recall that there was a Conference held on "Development Without Aid" in Delhi. I would like to make an appeal here today to the private sector, because I am sorry to say, that not only the public sector, but the private sector as well is not free from the defect in not using fully the available talent in this country for equipment and engineering services. For one reason or the other, we have formed this habit. While in the public sector, imports may be X, in the private sector it is about 1/3 or 1/4 X. We are not fully taking advantage of the local talent for engineering services and equipments. If we can increase the use of engineering talent in the country, then we can build up the necessary engineering talent that can help in the export of engineering goods in time to come, besides the import substitution.

I would finally come to the various suggestions that we have made in order that the engineering goods can pick up in exports much more than we did before. I have listed four or five items at the very end of my paper. I would like to share them with you. (*i*) Pre-devaluation concessional prices of steel and pig iron to be continued; (*ii*) the benefits of drawbacks for excise and import duty to be continued; (*iii*) certain import licences to the extent of imported contents in the exports, with one transfer, to be given with the express provision that these be utilized for essential industries and this can be a certain percentage of the export value; and (*iv*) where the devaluation does not fully cover the difference between the export and Indian price—this is a case in quite a few number of items—tax credit certificates to be given to the exporter. Tax reduction or remission to be given to the foreign collaborator who allows exports to pay for royalties. If he allows these to be exported let us give some tax credit so that he does not mind, because instead of getting 50 if he gets 100, he will be happy to allow us to export, if he gets that tax concession.

One more thing I would like to re-emphasize is the necessity of the import substitution. As I mentioned before, for the com-

plete 'turnkey' jobs, there is a necessity of encouraging the designing firms in this country. That is the biggest problem that we have in this country and that is why again I would like to appeal to this august body that you must try to encourage the Indian-based engineering firms—it may be that you may have problems but let me assure you that those problems would not be much different than what you have if we import these plants. Our own people would be able to solve the problems much faster and then what is more important is that knowledge will stay within the country.

I would also like to say about import liberalization. A study has been made, and I do not know whether it was widely publicized, because it was perhaps confidential, which had indicated that if all the engineering industries were allowed to work at full capacity and they were allowed all the free licences, the requirements are to the extent of 800 to 900 million dollars. If this is true, I do not think that free licensing could be continued too long, because we are not getting that much aid. So after all that much aid cannot be given to engineering industries alone. Chemical industries also may require about 100 to 200 million dollars. If that is the case, if we want to go on exporting, special arrangements will have to be made to the exporter so that he does import his requirements plus something more so that he can install new machinery in order to compete in the foreign market. He should also get components and new materials—provided they are not indigenously available—to make new products which after successful trial in India, can be exported.

I think we have already talked about import substitution. We have to import components. But unfortunately the Customs Duty regulations are such that while the complete machines can be imported at 'X', the components cost '2 X' or '3 X' with the result that people are discouraged from making complete equipment in this country. This has been happening for quite some time and I think this Seminar should seriously consider whether the time has not come when the duty on components for complete machines should not be less than for the complete machine. The engineering goods is one of our biggest imports in this country and unless something of this nature is done, it will not encourage local manufacture of the items. Today's policy is that it is cheaper to import machines and much more costlier to import

components. The cost of machines, even after the devaluation, will be much more in such cases.

DR D. T. LAKDAWALA

As far as the problems of devaluation and follow-up are concerned, I would divide them into two parts: firstly, the problems which really arise out of devaluation and the action which the Government have taken thereon and secondly, the problems which were already there before, on which devaluation or the consequent decision throws no special light. Devaluation has lent only a sharp edge to questions like the size of the Plan, the relative importance of the public and private sectors, etc. These topics have been controversial before, they are equally controversial now. The only note of agreement that has emerged is that deficit financing must be firmly eschewed and that extravagant public expenditure should be curtailed. On the second types of problems much has already been said, especially in the morning session. All that I would draw your attention to is that a great part of what has been said about the public sector has its counterpart in the private sector. For instance, Sir, when you say that deficit financing should not be resorted to, or that wasteful expenditure should not be indulged in, or that low priority investment should be eschewed, I presume you will agree, these demands do not only apply to the public sector. There is a danger of excess credit creation even regarding the private sector. The Reserve Bank data show that the expansion of banking credit to the private sector during the last few years has been much more than the increase in production even at the current prices warranted, so that in a sense there has been dangerous deficit financing in the private sector as well as in the public sector. Of course, as the powers of the two sectors are different, the mechanisms of deficit financing are also different. The private sector has been as guilty of wasteful expenditure as the public sector. There has been low priority investment in the private sector of quite a significant magnitude. I would, therefore, request you to consider carefully as to how much of what has been so forcefully said in criticism of the public sector applies to the private sector.

I shall confine my remarks mostly to issues that immediately arise out of devaluation. To my way of thinking, the most important problem is that of price stabilization. Price stabilization has become a pressing issue of national importance. Not only there is a vehement public demand for stability of prices, not only there is terriffic consciousness in the country about the dangers of inflation, but also the very success of devaluation itself depends upon our ability to tackle it successfully. It must be realized that, by itself, devaluation strengthens the inflationary forces in the country. Not only the rupee prices of the imports tend to go up, but to some extent, the domestic prices of the exports are also likely to rise. The success of devaluation depends on the shifting of resources from the domestic goods sector to the exports sector and the import-substitution sector. The process will cease when shifting ceases to be profitable which means that the price rise may communicate in due course to the domestic goods sector also. A price stabilization policy, therefore, becomes urgent. A reference was made earlier to the inevitable need for a rise in the general price line after devaluation. I do not think such a rise is unavoidable. Much depends upon the specific circumstances in which devaluation is resorted to, what is precisely expected out of it, the measures that the country is prepared to undertake to reduce domestic absorption or/and increase in production, and the success they are likely to have. After the 1949 devaluation, the Government of India announced an eight-point programme; one of the points in this programme was that the prices should be reduced. Such a policy would be valid in the present situation. A part of the price rise last year—and, in my opinion, a substantial part—was due to the bad monsoon. This should certainly not be regarded as permanent or normal. The Government of India has shown awareness of the need for price stabilization, e.g. grant of subsidies to imported food and fertilizers. There are, however, dangers from two directions which have to be specially noted and guarded against. The actual procurement prices for the next season of foodgrains are yet to be fixed; they should not by any means be raised. Secondly, there is already some evidence of a widespread demand for wage, salary and price revisions. If we are to get any substantial benefits out of devaluation, then at least for some time to come we must begin with rigid control on both factor prices

and commodity prices. If the post-devaluation situation is regarded as one of national emergency, the policy would find wide acceptance. I am afraid, this opportunity has been partly lost. The right time to take emergency measures would be simultaneously with devaluation, not two or three months afterwards. Even now, it may not be too late to launch on a serious price-stabilization programme. Obviously, most of the price-stabilization efforts would be confined to essential items or items whose prices can be easily controlled. Price-stabilization, therefore, will for its success rely on some sort of investment priorities, on policies of industrial licensing etc. I am, therefore, greatly surprised that along with the demand for price-stabilization, some people have also started agitating for de-control in a big way.

There have been two suggestions made regarding exports which need consideration. One is the question of export assistance to commodities which in spite of devaluation are not profitable to export because of the removal of export incentives. In the new set-up, there are two questions which you have to answer if you want to establish a case for subsidizing them. Firstly, it has to be shown that the earlier schemes were conferring on these exports much greater benefit than the present devaluation. Hitherto, both the Government and the business systematically underestimated the extent of assistance. Both of them forgot that besides them, there was a third interested party viz. the public, which had to be also taken into confidence. Now that a large part of the assistance will have to be more open, the issues will have to be thrashed out. Would it not have been more in the interests of public relations and public co-operation, if the businessmen and the Government had made earlier efforts in this direction?

The second question that you have to consider is that if heavy subsidies are demanded despite a large current dose of devaluation, a very strong case will have to be established more or less on the same lines as that for protection before the Tariff Commission. When the Government decided to devalue, this decision implied that the country was going to do away by and large with the differential elements in the treatment of export and import commodities. This may be a good decision or it may be a bad one. But it implies that if there are to be any subsidies for ex-

ports, these would be marginal and for a limited period. Exporters arguing for subsidies now must show not only that they would be incurring immediate losses by exporting but they should also say in what way the products will benefit from subsidies, and show that after five or seven years they would be able to face world competition and move without assistance.

Another suggestion that has been put forward is regarding Indian investment abroad in order to increase our exports. I think there are occasions when such investments may be justified. From the viewpoint, however, of an immediate increase in foreign exchange receipt, one has to be rather careful about investment abroad. What we want is not only more export, but also more immediate foreign exchange receipts, and from that viewpoint the role of a liberal foreign investment policy is extremely limited.

For the success of price-stabilization and even long-term export policy, a proper fiscal and monetary climate is an essential desideratum. From that viewpoint, Sir, there is one demand which has rather surprised me, and that is the demand for a large-scale tax reduction. I can understand that there would be certain commodities where the tax burden is so large as to considerably restrict demand; at the same time there is excess production capacity. In such cases, with some reduction in taxes, demand will increase, the production of the commodities will go up, and tax revenues will become buoyant. I am afraid that these are bound to be rather exceptional cases. In other cases, tax reductions will mean less tax revenues. Unless you maintain that the size of the public expenditure should be curtailed very drastically, you will have simultaneously to consider the effects of tax reductions on deficit financing. As far as I can see, any reasonable reduction in the size of the public expenditure or the size of the Plan will not make possible a large reduction in taxation. Firstly, in an underdeveloped economy, imperative developmental needs demand a large public sector. Besides, in the Indian economy, a decrease in public expenditure will adversely affect the demand for the more dynamic products of the private sector. For instance, after the Railway Ministry reduced its orders for wagons last year, almost all the reports of engineering concerns are full of complaints about the way it has affected them. The complementary nature of the public and private in-

vestments must be taken into account before pressing for a reduction in public expenditure.

As far as monetary policy is concerned, the problems given rise to by devaluation are fairly simple. The legitimate needs for credit will partly depend upon the likely imports in future, which may fall short of the licenses issued. Businessmen may not like to fully utilize their import licences because they cannot get complementary domestic resources or they cannot get the necessary finance. The foreign credits now given cannot, therefore, furnish a fair idea of the future additional productive demand for credit. What has to be ensured is that any additional credit that is created to accommodate greater imports is either counteracted by the contraction of credit in other spheres, unless you are sure that the credit given is likely to lead to an increase in production in the short time. Otherwise, the credit creation is bound to be inflationary and will lead to the very consequences whcih have led to devaluation and which we are trying to avoid in the future.

Dr S. K. Muranjan

The subject is rather a vast one and so much has been already said. I propose to be very brief. It will serve no useful purpose to hold a *post-mortem*. The most urgent task before us now is to devise measures by which devaluation will inflict minimum of harm and give us the maximum of benefits. When a country undertakes devaluation, the objective is simple and clear. Its prices and costs are above the prices and costs of foreign countries. The object, therefore, is to bring about something of an equilibrium in domestic costs and foreign costs. When I read that devaluation was to be 57 per cent, I did ask myself the question, why 57 per cent? Which costs and prices did the Government take into consideration? The economic conditions in the country are now such that it is difficult to speak of an average or a general level of costs and prices. Thanks to our politicians, there are in this country today as many costs and prices as there are zones. Your D.A. is linked to food prices. These food prices show a great disparity. For example, wheat is selling in the Punjab for Rs. 40 per quintal, it is selling in Maharashtra at

Rs. 110 per quintal. To which costs and price levels is the devaluation supposed to adjust itself? After all devaluation operates under certain assumptions. When England devalued, she was relatively a free economy, capital and labour could move from one industry to another freely and the whole country therefore had an average level of prices and costs. Now ours is a planned economy which is riddled by controls of all kinds. This has caused disparities of costs and prices in the country itself. One should have first of all removed all the obstacles which prevent an approximation of wages and costs. Otherwise, the fundamental distortions in the whole economy will remain in spite of devaluation and the efficacy of devaluation will be reduced.

The second point that I want to raise is this: Devaluation undoubtedly creates an inflationary psychology. As a matter of fact, we have to bear in mind that under devaluation, we expect our imports to fall and our exports to increase. How does that expansion of exports take place under devaluation? It takes place in two ways. You will have some expansion in production, a point on which I shall say a little presently. At the same time, devaluation brings about a certain fall in domestic consumption. The reason is very simple. By devaluation, we have made cheap our commodities, cheaper to the foreigners. Some commodities are more cheap, others are less cheap. If they are about 5 percent above prices and costs of the rest of the world, there is a substantial stimulus to demand under a devaluation of 56 per cent. It is 10 per cent higher they receive relatively less stimulus. If prices and costs of the particular commodities are 30 per cent above world prices, there is still stimulus. But the point is that because these commodities have become cheaper to the rest of the world, there is an enlarged demand and naturally domestic prices tend to rise. When domestic prices rise, there is a fall in consumption and the fall in consumption indicates how immediate exports surpluses materialize. To devalue the currency on the one hand and then to expect that there will be no price increase at all, is to misunderstand how devaluation operates to achieve the object in view. Why undertake devaluation—if we want at the same time prices to remain what they are? When we talk of stabilization of prices under devaluation, we mean that devaluation sets a limit within which we have to stabilize our prices. If the prices are allowed to go up above that limit,

another devaluation will have to follow. Some stabilization has to be there but we must not ignore or overlook the fact that unless there is some rise of price in certain commodities, no export surplus will materialize and therefore, devaluation will not become effective.

The third point that I want to place before you is this: We all now say that we must encourage export-oriented industries. That indeed is the one big tragedy of our Third Plan. How is it that we are now talking of encouragement of export-oriented industries? Why did we not plan our exports from the very beginning? The answer to this question is clear when we remember the link between planning and foreign aid and foreign loans. We have now to revise our whole attitude to foreign aid and foreign loans. To put it very briefly, our attitude to foreign loans and foreign aid has been as naive as our attitude in the field of foreign policy of our country. We thought that we have merely to proclaim the principles of Ashoka and our strict adherence to peace and everybody will accept us as the sponsors of peace over the world and nobody will invade our country and nobody will disturb our peace. The same naive attitude we have assumed towards this question of foreign aid and foreign loans. We thought that all foreign loans and foreign aid are stringless, and we have nothing to fear about pressure from outside. We overlooked in our naivete that aid and loans have always one powerful string attached to them—the string of saying at any critical stage—"No more any aid or loans."

The second point about which we were naive was this: After all we had not one plan in view but several Five-Year Plans. Most people who talk about 'take off' never understood what 'take off' really means. The usual assumption was that we shall require four or five plans before we reach that stage of 'take off.' Now if we knew that there were to be four or five plans before the stage of 'take off' was reached, was it not commonsense to make sure that foreign exchange is assured to us for next four or five plans? Could we really base our planning on mere piecemeal negotiations of foreign loans and aid? If we have a realistic sense about what planning is, we should have known the dangers of the dependence on foreign aid and loans. We should have negotiated not for one year or 5 years of aid, we should have sought a positive assurance for the next 20 or 25 years. I wonder what our

perspective planners were doing when they were drawing up our magnificent plans, based largely on foreign aid and foreign loans. I grant that we want a high speed of development, we have got to have foreign aid and loans. But we were bound to make sure that such loans were assured not for one year or 5 years but over a period of 15 or 20 years. Otherwise, we should never have embarked on planning on this scale at all. Hence I say the whole thing about export-oriented industries is a great tragedy. Instead of this naive attitude, we should have really adopted a realistic attitude towards export-oriented industries. We would have been today in a far safer position than we are now.

I must point out to you that encouragement of export-oriented industries is not a simple question. You know, 5 or 10 industries which are exporting at present and from a study of their cost structure, we should be able to make out that these are industries which should expand. But remember that when a country adopts devaluation, the whole price-cost relationships between industries change. It is quite likely that some industries which were not exporting before may now fall into the category of export-oriented industries. It is therefore not easy to put your finger on particular industries and say these are industries which are export-oriented and those others are industries which are not export-oriented. It all depends on the new structure of prices and costs which will be evolved as a result of devaluation.

One last point, and I shall wind up my remarks. The point that I want to raise is about money and credit. There is no doubt as was said a short time ago, when a country devalues, an extremely inflationary trend is created. For some time at least, we have got to maintain our present credit and monetary curbs. But devaluation is always based on the premise that production will expand. If you really want production to expand after six months or one year, after some stabilization of prices is established, a revival of the capital market becomes very urgent. We have to think of various measures, perhaps relief from taxation is one measure. But I think some revision of interest rates may be necessary if the capital market is to be revived. We have to approach the subject very cautiously and in a tentative manner. Even at present there are industries which are at an advantage because their wages and costs are relatively not so very high.

If these industries are to expand, then capital has got to flow into them freely. At present because capital is not available in the market, trade and industry have to make use of deposits and short-term accommodation. This cannot go on indefinitely. We cannot gear up the whole structure of trade and industry on deposits of 6 months or one year and short-term loans even if these are obtainable from banks. If these term deposits and short-term money are to be released for working capital, as they should be, then we have got to do something by which the volume of permanent investment fund will grow. That volume of permanent investment funds will grow only if the capital market is revived and appropriate fiscal measures and appropriate money credit measures are undertaken.

SHRI VITHALBHAI PATEL

Well, I think, it is time that we have devaluation in speeches also. I would, therefore, only say that so far as this audience is concerned, we are talking to those who are already converted to the idea. I agree with the technical approach of a short-term duration made by Mr Tandon and with the objective assessment of the situation made by Mr Da Costa and Professor Lakdawala. We have to say what we want the Government to do. What should they do about having price stability and containing inflation? What do we want them to do for encouraging exports? What do we want them to do for encouraging those imports which will more or less keep the industry to attain full working capacity? These are the four or five points on which we will have to concentrate. While we are telling Government not to resort to deficit financing, we should also tell them how they should meet their requirements which are absolutely necessary without resorting to Deficit Finance.

SHRI A. R. BHAT

Devaluation is now a fact. I would emphasize on some of its specific aspects. Take the foreign debt of India. How has it actually piled up? We find that it has not been incurred only

for financing our capital goods requirements but also for maintenance imports. They must be reduced. Further, we are not seeing to it that there should be no food imports. Unless we place emphasis on agricultural production for the purpose of making ourselves absolutely self-reliant and self-sufficient in the matter of food and also in the matter of commercial crops produce by increasing productivity, this problem of imbalances in our foreign trade will not get solved.

Another point is about small-scale and ancillary industries. Shri Bhattacharya has referred in his speech to the development of ancillaries and also advised inculcating Swadeshi spirit in that behalf. Large-scale industries instead of depending on the import of components should rely more on the ancillary development for their supply. But the position is this: the new liberalization policy regarding imports is likely to hurt the small-scale industrial units which are nascent. As a result of the protected market due to curtailment in the import of components and other materials, the small-scale units, both independent or ancillary, have begun to grow, and import substitution has been taking place. If import liberalization is not sufficiently discriminating, I am afraid, there will be a set-back, at least over a short period that is ahead of us to the development of small-scale and ancillary industries. Therefore, we have got to take steps that whatever industrial development that we are planning, whatever ancillary development is already there and is in the offing is protected under the liberalized scheme. Unless we do this there will be a set-back at least immediately to the development of ancillary and small-scale industries. Complaints have already been made in that behalf. What has been happening is this. Some of the components and other items which were allowed to be imported in the year 1964-65, were banned in 1965-66. Even the imports in 1964-65 were very much restricted. But since the imports have been sufficiently liberalized in the case of scheduled industries and to some extent in the case of small industries, and all items imported in 1964-65 are allowed to be imported, what would happen to the infant industries that are developing the production of those items? Ultimately, the salvation of the country lies in developing 'swadeshi' industries. We want swadeshi industries, we want import substitution. If import substitution is to take place, Government must take a dis-

criminating view while allowing liberal imports for the utilization of idle capacities. This point needs to be taken note of.

SHRI H. T. PAREKH

Two months have elapsed since the fateful decision of devaluation was taken. We have met here today to discuss how we could make it successful. Devaluation is the result of inflation. What we have now to take care is that it should not be a cause for further inflation. Many of the speakers have already stressed the need for price stability. This should enjoy the highest priority. Since the price problem and the cost problem are affecting a variety of goods and involving variety of factors, I think it is up to every institution, particularly, Chambers of Commerce like this as well as Government to devote maximum attention to examining these problems and to find out the causes which have led or are leading to further rises and, in particular, the rise in the prices of articles that are used for daily consumption. The consumer has been the most exploited of persons between Government, industry trade and agriculture. I think it is high time even the Chambers of Commerce which represent trade and industry, turn to the consumer who is ultimately the salvation of both trade and industry.

We have all recognized that this is a complex problem. It has various angles. Whenever industrial costs go up, all that industry does is to agitate for a price increase. What is perhaps more desirable is instead of a price increase which affects the consumer, the reasons for rising costs have to be looked into and in many cases, the Government, because of various excise duties, sales tax and other customs duties and so on with all the forms of indirect taxation, is very largely instrumental in raising the prices of various commodities. I think from the trade and industry's point of view, even where price rise has to be conceded, the emphasis should be that Government should reduce the excise duty so that the consumer may not bear a very large burden. I think the Federation has passed a resolution to that effect and that is the right move because in that way, the consumer is saved from paying high prices. I would like to quote the example of sugar. Sugar has been mostly a controlled

commodity. Year after year, Government fix higher and higher cane prices. Not only that, but the control works out in a fantastic manner. The result has been that we are paying five times more than the international price for sugar. It is difficult to understand why Government, in spite of having been in surplus condition, has not thought it fit to relax or remove the controls so far as the prices are concerned. These are indications to show that in articles of daily consumption, the policies, whether it is in regard to controls, prices or excise duties or a combination of these policies, have resulted in exploitation of the consumer and I think, it is the moral duty of trade associations to take up the case of the consumer even though it may be against the interests of its own members.

Coming now to the question of exports, it seems to me that, as Dr Muranjan has rightly said, there are industries, of which some may be favourably affected and some may be unfavourably affected; in any case, however, increase in exports is going to be an extremely slow affair and we should not count very much on a rapid rise in exports in the short term. Even if exports go up, it will require many measures. It is going to take a very long time. In the short period, it seems to me that greater results will be achieved by reduction in imports. That is because imports after devaluation have become more expensive. There is not the same urge to import as there was in the past. As a result of that, in my opinion, the industries are bound to be benefiting because people would turn to indigenous industries more and more because of the expensive character of imports. I would like to give support to what Mr Bhat has said that the indiscriminate import licences might hit the ancillary and small-scale industries and there is very real danger that industries which are just coming up might be affected by too liberal imports. This is also very important to bear in mind. Lastly, Dr Muranjan has rightly indicated the monetary side of the picture *and* in regard to the interest rates. Here again, I think, the emphasis should be more and more how to lower costs and prices of money as it is also one item of cost. A fresh look at the fiscal and monetary policy is called for with a view to bringing about some lowering of costs. So far as the money situation is concerned, people have variously indicated where we will find the resources. But as we know, from the resources

of each successive plans, as Mr G. L. Mehta indicated earlier, this is not a static thing and resources increase with development and growth and we should not be too much apprehensive of resources if we have more production.

There is only one point about deficit financing which has been greatly stressed. It seems to me that there is a little too much stress on deficit financing as such, and all Governmental policy is based on how to check deficit financing. It seems to me, what is more material, what is more damaging is not so much deficit financing itself; but as of the capital waste, wasteful expenditure. If the expenditure is productive, deficit financing could be sustained. By emphasizing too much on the problem of deficit financing, authorities are turning more and more on the monetary measures, forgetting the price factor and the need to tackle the complex price problem which needs to be looked into from various angles. On the one side, Dr Muranjan has also indicated that some resurgence of the capital market is required and apart from the reasons he has indicated, the major reason in my opinion is that all the heavy investment which we have made in the last 10 or 15 years is to build up capital goods industries and these industries are all suffering from lack of orders. This is indirectly a reflection of the state of capital market. So if the capital market is to pick up there should be more investment and more demand on capital goods industries and, therefore, the capital goods industries, which we have established in a variety of ways, need to be nursed if these investment industries were to fructify and not to go waste. This, in my opinion, is an important reason, apart from any other reasons, for bringing about revival of the capital market. There again, it seems to me, one means by which this could be achieved is with some lowering of interest rates. Dr Muranjan has also said that in other countries, particularly in Great Britain, they raise the interest rate, they raise the Bank rate, and very soon they lower it also. We should also have some kind of strategy so that we may serve different objectives.

So far as the exports are concerned, one more thing which I would like to mention is that, apart from commodity approach to exports, we should also have an approach to intensify efforts to sell to certain countries, particularly, neighbouring countries like Burma, Malaya and Indonesia etc., since we have the advan-

tage of devaluation. I am glad that the Government of India is taking some more interest in the Indonesian economy; they recently gave a loan of Rs. 10 crores. It is true that there is a lot of instability in that country, but we have to study that market, when stability is established. It is a good market for our capital goods industries like the Sugar industry, Paper industry and so on; we can sell machinery. We have to work out ways and means by which the right kind of export credit is granted. But once we want to sell capital goods outside the market, we have to work out its own pattern of giving different payments and other things for which suitable facilities have to be obtained here. One interesting example is the Bokaro Steel Plant. Russia is going to supply machinery worth Rs. 150 to 200 crores on a 12-year period credit. We have already started repaying before using, because we have taken the know-how and all that, for which we have to pay. When we have to sell capital goods, as the Japanese are doing in things like machine tools and others, each category of capital goods requires a certain kind of financial arrangement and this is a technique which we have to learn fast, if we want to sell and it is only through sales of capital goods that we will be able to step up our exports. This is a repaying proposition. Now that we have built up capacity, we have to turn more and more from the consumer goods to capital goods.

We should not feel despondent or pessimistic about the outlook. I think, for industry as such, devaluation is really a God-sent, and once industry settles down, industry will begin to feel the benefits of it.

SHRI PRABHU V. MEHTA

A follow-up action after devaluation must ultimately result in generation of wealth. If this is true, then atmosphere conductive to the generation of wealth must be created. The first and foremost thing is the change in the motivation and attitude of administration. The motivation and the administration at all levels should be action-oriented. The attitude towards work should be creative. The purpose of the administration is not to hamper production and prevent effective productive efforts. The

purpose of the administration should be to assist production and productive efforts. It has been stated here that administration is not efficient. I beg to differ. So many efficient and clever businessmen have succumbed to various kinds of administrative efficiencies which has resulted in hampering production. They are efficient in their own way. They are not efficient the way we want them, i.e. to assist in production. We all know controls have failed. Therefore, there is a need to change the policy in regard to the control.

Without good industrial relations, productivity and production cannot increase. We have plethora of labour laws but these laws have not been able to improve industrial relations. I suggest as a follow-up measure that in the field of maintenance of good industrial relations most of the agency should bipartite and not tripartite. As far as possible the Government should keep themselves out. Our Trade Unions are politically oriented and, therefore, devoted to certain political ideology. This also comes in the way of good industrial relations. The follow-up action should be to free the trade union movement from political influence.

Another next important step as a follow-up action after devaluation should be development of indigenous technology and technological know-how. This unfortunately is not being done in India to the extent we wish. The Youth must develop technological attitude. The Youth has no facilities to do so. In other countries where the technology is developed, the Youth has been given facilities to experiment and learn. In any other democracy, even the Taxi Driver can use a Transmitter and a Receiving Station. It is a crime to make one in India without a licence and the licence is generally not granted. It is an offence even if you build a transmitter to talk from bed-room into the kitchen. This kind of restriction should be done away with at the follow-up action. We have Bhabha Committee's Report on development of Electronic Industry. This development can never take place unless Youth has an opportunity to learn electronics as a hobby. In plan we talk of resources by which is generally meant money and materials but the greatest resource is being forgotten in the plan i.e. human resources. Human being by his initiative and enterprise and improvisation and imagination can achieve a lot towards fulfilment of economic goal. This is not being considered at all. The people are missing in the plan.

Sir, these are the three points that I did wish to make:

1. Change in the motivation and the administration.
2. Good industrial relations, by negotiation between the employer and the employee.
3. Development of technical know-how and freedom of action to entrepreneurs.

SHRI J. H. DOSHI

Dr Bhoota and Mr Prabhu Mehta have touched the problem of exports. I completely agree with them. No doubt, we have at present received untied loans and so liberalized imports in order to enable the industry to work to full capacity. But I am not sure what will happen next year. Where is the guarantee that we may not be placed again in the same difficult situation? The Government have suspended all assistance for exports. We believe that the Government will agree to give some assistance, one way or the other, to stimulate exports. We have got to increase considerably exports of non-traditional items and the incentives might not be enough. Therefore, some sort of urge to export is necessary and this can happen only if imports and exports get tied up in some way. Those industries which need 10 per cent of imports should be forced to export enough to earn their imports. Industries like the Engineering industry, which, as mentioned by Dr Bhoota, require 20 per cent to 50 per cent imports, and which holds good for the Chemical industry also, may be given some basic imports to keep them going; but the rest of their requirements have to be earned by themselves. They may be given necessary facilities to import for two or three years' time to be self-sufficient to as large an extent as possible. I do not know to what extent it should be made applicable to capital goods also. If an industry wants a plant and wants an import licence for Rs. 50 lakhs, they must promise to earn that amount of Rs. 50 lakhs within a maximum period of 10 years; otherwise, financing imports of such capital goods will be of no use to the country. If we don't link up exports with imports in future in some manner, I am afraid we are going to be landed in the same difficult situation as before Devaluation.

Dr R. C. Cooper

The first point with which I would like to deal is the very important point raised by Dr Lakdawala regarding the limitation of the policy of tax-cut. With very great respect to Dr Lakdawala, I beg to disagree with him. There has been a classical theory of taxation which says that the State must go on taking out of the profit made by the private sector as large a chunk as possible and this should go on increasing year after year. We have been practising this classical theory for quite some time, with very deplorable results. We have before us the examples of large number of other countries where modern policies are being followed and these are not necessarily very highly developed countries like UK, USA and West Germany. Small and developing Israel, has experimented with the modern theory and this has proved very successful. This modern theory is that the State should take out of the profits made by individuals and companies, as large a chunk as possible, but out of increasing revenue. Even though there may be a massive cut in taxation, not only as a purely long-term result but even of a short-term period, the amount of revenue which the State would collect will be very sizeable. The basis of this modern theory is three-fold. The first is that any sizeable cut in taxation reduces the incentive for tax evasion and as a result of that factor alone, the revenues collected are more. The very basic factor, however, is that there is a terrific psychological incentive through a massive taxation-cut and invariably, as a result of this psychological thinking, production goes on increasing at a much faster rate. Consequently, the amount of revenue which is collected is very sizeable. The third factor is that, quite apart from the incentive for more production and reduction of incentive for evasion, there is also a natural tendency to look out for wastage. As Dr Lakdawala has pointed out, the question of wasteful public expenditure arises not only in the public sector, but to a considerable extent in the private sector also and one of the fundamental things which contributes towards this wasteful expenditure in the private sector, is the very high rate of taxation. People would prefer to enjoy and spend more on certain avoidable type of expenditure if they are left with a small portion in their pockets after payment of taxes.

Therefore, I am of the opinion that at this stage, with the devaluation of the rupee, there is need for a very sizeable tax cut of our economy.

We should recommend that a start should be made by doing away with the 10 per cent surcharge which was levied in the last Budget, both on companies as well as on individuals. If at all there could be certain safeguards taken by Government to ensure that, at least, as a temporary measure, any tax cut which is given should not be utilized for purposes of distribution of dividends or frittering away, but utilized entirely for higher production. This, it is not difficult for the Government to ensure. We have got a parallel mechanism available in that context in the matter of development rebate where an amount of 75 per cent of the development rebate is required to be credited to a special reserve account for the purpose of business expansion. Such mechanism can be evolved simultaneously with the removal of the 10 per cent surcharge.

In the field of direct taxation, the other important point to which a reference has been made by some speakers is the allowance of additional development rebate and depreciation, on the higher quantum of cost of machinery which will now arise either directly, or indirectly on account of increase in the liability under foreign exchange loans. I must utter one word of warning. We are accustomed to the peculiar mental working of the members of the Central Board of Direct Taxes who are responsible for advising the Finance Minister on all matters of direct taxation and their mentality always has been to go by the strict letter of the law. I am afraid, if in this matter of allowance of development rebate and depreciation and other expenditures, a pure technical view is taken, in a large number of cases, the legal position will be rather obscure and not very favourable to the tax-payer. It is, therefore, very essential to tell the Government, that in a matter of emergency like the devaluation, the costs have gone up, because of uncontrollable factors beyond the control of businessmen. A strictly legalistic view will be of no avail. In every case, whatsoever, where the liability has gone up, whether financial liability and the loan repayment or directly cost of plant and machinery has gone up, the additional amount should be allowed to be added to the cost of plant and machinery for the purpose of development

rebate and depreciation. I understand, that some very concrete thinking in this matter, at the moment, is being done at the Finance Ministry stage and, therefore, I feel that this particular point should be very strongly pressed at this stage.

In the field of indirect taxation, I completely agree with Mr Parekh, a very substantial relief can be generated through cut in excise duties particularly in commodities where the burden of excise duty is exceedingly high and particularly in respect of items, where, because of devaluation, the costs straightaway go up by 57 per cent because of no fault on the part of businessmen. There is nothing which he can do about costs going up on account of the imported components and raw materials. Now on this question of giving relief to the mechanism of excise duties, the only possible objection which the State can put forward to is that it is likely to lead to loss of revenue, which the Government cannot afford at this juncture. Our answer to this is that the Government has already announced its decision to reduce expenditure by 3 per cent in some cases, and 5 per cent in others, and to the extent to which these savings to public expenditure is anticipated, there could be immediate extension of relief of excise duties in the deserving cases where, because of devaluation, the higher cost is absolutely inevitable. This is the only way in which the price line can be held.

Coming to exports, several points have been made. The only point, I would like to make at this time, for the consideration of the industrialists, is that although, I do concede that the price is a very important factor in promoting our exports, there are certain other very vital considerations which have been laid out in one or two papers but which have not received sufficient attention at the hands of the business community and the industrialists. I would, therefore, like to put forward this point, namely, that besides the price factor, we have to do a lot more for the purpose of promotion of exports, in such things, as for instance, salesmanship. A very considerable amount of scope for increase of exports would arise, size being what it is, through proper salesmanship, through a greater attention being given to consistency in quality—there have been lots of complaints about the inconsistency in quality from our foreign buyers—one would think the way in which the product is packed or a strict adherence to the shipping instructions given by the buyers

and the speed with which the goods are shipped are very equally important. Finally, there is an important factor of introducing a considerable amount of flexibility, particularly as far as the export goods are concerned. This flexibility should arise in the matter of adaptability of the particular product in foreign countries. I would venture to submit here again, we have not been sufficiently flexible as far as our export effort is concerned.

Dr Lakdawala has made another point and that is limitation regarding capacity of this country to export capital to other countries and if I understood him correctly, what he meant was that there was only a limited scope for our industrialists to go into foreign countries and make investment in such foreign countries. I see considerable amount of force in his argument, but there is one other related matter which may solve this problem. and that is the possibility of our industrialists being able to give valuable technical know-how to people in certain countries where there is fairly good availability of capital. I would particularly refer to countries like Kuwait and other oil kingdoms in the Middle-East, where any amount of capital is available, but there is a lack of availability of technical know-how. As a result of our economic planning for the last 15 years or so, in many fields of activities, we have acquired very valuable technical know-how, which could be made available to these countries and which would mean that we will be earning foreign exchange without any substantial investment at all.

In the matter of import liberalization, although everybody has welcomed the import liberalization, a very important point has been made, viz., regarding the availability of credit for the purpose of utilizing import licences and Mr Parekh has very rightly dealt with this point. I do not agree either with Mr Da Costa or Mr Kamalanayan Bajaj. Mr Da Costa, who put it to ask that even a simple bank advance would amount to creation of further inflationary trend and deficit financing, and the other extreme view which was advocated by Mr Bajaj that any amount of deficit financing may be resorted to as long as it is productive. We have got to find a midway between the two.

The last point which I would like to deal with is the very important point which was repeatedly made by speaker after speaker about the personnel of the Planning Commission and the various mistakes which have been made by the Planning

Commission in the past. Mr Bhabha expressed very strong views in the matter of the Planning Commission and practically every speaker has referred to the very close association of planning with the problem of devaluation. Now, one practical suggestion which I would like to put forward for the consideration of this House and may be incorporated in our conclusions, is that there are going to be in the near future—it is understood—three vacancies in the Planning Commission, three of the 'theoretical' economists are going out of the Planning Commission. We may suggest to the Prime Minister that this is an excellant opportunity for reorganizing the Planning Commission by filling in these three vacancies by people who are experienced in business, industrial, financial and banking conditions and so on.

Dr Ram Gopal Agrawal

The first point I would like to touch upon briefly concerns the establishment of joint ventures abroad. It was mentioned here that this is not in the larger interests of the country. I personally feel that, as an export promotion measure, it is highly important and has become more important pursuant to devaluation. It is important not merely from the point of view of the entrepreneur who is establishing joint ventures abroad but also from the wider national point of view because thereby we would be able to export certain goods, which otherwise we would not be able to export. And it is the Government's policy not to allow any capital outflow, all that happens is capital equipment is allowed to be exported. I would not elaborate more on this point.

The second matter I wish to refer to is the point which has been given in the paper submitted by Mr Bansal about import substitution and the use of tariff mechanism to regulate imports. Now all of us are rightly concerned that there should not be indiscriminate imports after devaluation, otherwise it will lead to closure of certain ancillary units as well as other industries. The point to consider is whether we cannot now take recourse to tariff mechanism in a slightly bigger way. I am not suggesting at all that tariff mechanism alone could regulate imports. We should certainly ban imports of items which we are produc-

ing and which we are capable of producing but whether by increasing import duties in certain cases and reducing them in other cases ,we cannot regulate imports. For example, our tariff structure is not rational. Even after devaluation we are maintaining high rates of duty which were levied in August 1965. Since we are not producing, and will not be able to produce certain types of capital equipment, why should we have high rates of duties on items which we will not be able to produce for another 5 or 10 years? On the other hand, it may be that there are certain marginal cases where by levying higher rates of duty we can make imports free and let the market forces operate. If this is done, we will also have to look at the commitments which India has made under the General Agreement on Tariffs and Trade under which we have bound the rates of duty at certain levels beyond which we cannot raise them.

The third point I wish to make, is that after devaluation, it is absolutely necessary to liberalize the economy to the maximum extent possible and it is not right, therefore, that we should have controls to maintain the prices. I would refer to the short-term and long-term aspects of the matter. While we are all concerned at the present moment about maintaining prices but if, in our desire to maintain prices at the present level, we introduce controls, I think we would have to face more problems in the future—we would only be postponing our problems—and this will not be in the interests of the economy.

Dr P. R. Brahmananda

Differences on economic policies are not necessarily due to difference in the degree of desiredness of plans for the betterment of the poor. There can be genuine differences on the issue of devaluation. Those who welcome it may do so though not for identical reasons. Similarly, those who are opposed to it may hold divergent views. The real point is whether it would have been possible for us to have sustained for long the pattern of economic, particularly industrial, development that we commenced at the end of the First Five-Year Plan. This pattern has implied a high and rising ratio of dependence upon other countries for imports both for project and non-project, presumably

maintenance purposes. A rough estimate indicates, in the manufacturing sector including mining and small enterprises, the ratio of dependence upon maintenance imports is about 30 per cent of gross value of output; but the total exports that flow out of this group forms only 5 to 6 per cent of the value of the gross output. There is thus a substantial degree of non-self-financing with respect to foreign exchange resources for maintenance purposes in this sector. The crucial issue is: how long could we carry on this arrangement. It would therefore, appear that the economy needed a sort of shock in the form of a devaluation in order that requisite readjustment can be initiated. If we look at devaluation from this angle, one realizes it had to come, at some stage or the other. The prospect of eventual devaluation was built in the pattern of development that was initiated at the beginning of the Second Plan. A rethinking, therefore, has to emerge whether we like it or particularly in view of the growing imbalances in our exchange situation. We have, therefore, to bring about a readjustment of the pattern of resource-allocation. We have to reduce the size of our real import bill; and, we have to raise the proportion of exports to gross output.

Granted the need for a reduction for our imports and for a rise in our exports, it does not necessarily follow that aggregate monetary and credit expansion is a precondition to bring about the above results. I would expect, on rough calculations, that as a result of devaluation the level of prices of industrial goods would move up by about 20 to 25 per cent. This order of rise may come about over a period of 6 to 7 months. If this rise in industrial prices is to be prevented from causing a rise in the general price level, aggregate economic policy has to be rather stiff. Monetary demand has got to be kept constant. We have to adopt what is termed as a 'neutral-monetary and fiscal system' If credit supply is not increased, and if restraints in fiscal expenditures are observed, it automatically follows, one has to allow interest rates to move up. The increased demand for bank credit have to be made out of savings, implying a withdrawal from the current demand for consumption goods.

A reference has been made to the depression in the capital market and it has been pointed out that this is due to lack of incentives. In this connection it has been suggested that we should re-introduce low interest rate policies. I would, however,

strongly differ from the above interpretation for the cause of the stagnation in the capital market. My impression is that the ratio of savings to income has gone down in the Indian economy over the period of the Third Plan. A chief cause for the decline in the savings ratio is the steep rise in prices. The stagnation in the capital market is largely attributable to a decline in the savings rate. During the last three years, major upward adjustments in the interest rates have not taken place. I would strongly plead for an upward adjustment both in interest rate and in the profit rate. Contrary to the common impression, interest is not a cost element. A determined policy of upward interest rate implies an upward drift in profit rate, and corresponding relative restrictions on wages and salaries and on consumption. Devaluation, therefore, poses before the economy rather hard choices in economic policy. Unless we are able to reduce our import dependence and to reduce our consumption of exportable commodities, the foreign exchange gap cannot be reduced. The time therefore has come for a drastic deflationary policy. No doubt a drastic deflation is bound to cause localized unemployment adjustments. Provision for unemployment problem should be made through specialized agencies. If we do not take drastic measures now to prevent the upward drift in the price level, I am afraid, we may not be in a position to avoid for long the sort of crisis that overtook Indonesia.

DR KERSI D. DOODHA

From the trend of the discussion so far, I find that we have been indulging in a little confused thinking on the strategy that the Chamber has to adopt to meet the 'Challenge of Devaluation'. One of the speakers, for instance, said that he favoured the generation of wealth irrespective of who produced it under any circumstances. The same speaker added that he was impervious to dogmatic thinking so long as wealth was created, because that is ultimately the meaning of the challenge of devaluation. Well, Sir, in my opinion the whole problem is to be viewed in an altogether different light. We have certain goals or economic objectives which have been very clearly laid down. The Chamber has necessarily to function within them. One can-

not boldly disclaim their operation. At the same, it is futile to rule out criticism of these goals and the means adopted to realize them. However, such arguments criticizing the strategy of planning and the very norms of economic policy should not be the business of the present Seminar. It should fall within the overall policy of the Chamber in a different light, and where it is in agreement with the above view, it may continuously agitate for its realization.

For the current discussion namely, the problems arising out of devaluation proper, our purpose should be limited. It must be for all purposes one of suggesting minor or major adjustments here and there, so that our recommendations may carry not only weight, but lend itself to ready acceptance by the Government without offending or prejudicing other sections of the community as well. We have, therefore, on our part to maintain a certain degree of balance or equilibrium in our demands. This has been well stressed by Mr Eric Da Costa and Dr D. T. Lakdawala and supported to a large degree by Dr Rustom Cooper as well.

Coming to the discussion proper, I feel that we have succeeded in developing a consensus on certain points. One of these relates to the aspect of deficit finance. We have claimed that it is undesirable for the public sector and should be entirely dispensed with. Against this at least, two speakers have pointed out that deficit finance in the private sector is almost equivalent in character to the deficit finance practised by the public sector. The paper recently published in the *Reserve Bank Bulletin* by Mr Pendharkar and Mr Narsiman has been pointed, as a classic example, which seeks to prove their observation namely, that deficit finance has been resorted to by both the private and the public sectors with disastrous results. I beg to differ with this kind of an equation because we are well aware of the manner in which bank loans are being granted in our country as compared to foreign countries. By and large, credit through the banking system in India is generated on the basis of either a cash credit, a key-loan arrangement or the overdraft system. We have very little term-loan arrangement in our country. As a result of the type of credit system prevailing in our country we find that, by and large some asset, either a physical one in the form of commodities or raw materials, as well as a capital asset

or a financial asset, must have been generated in the system prior to the grant of a loan. To this extent credit in India merely adds to the liquidity of assets not create them.

It may be countered that assets so generated may not belong to the category of a priority industry. Our objective is to finance only the priority industries. To meet this argument another question has to be posed: are the commercial banks responsible for channelling credit into the priority sectors? My answer is that banks are not responsible for inquiring into this kind of business. It is the job of the Government to look after the realization of this objective. The *have* to see that credit percolates into channels in which they want investment to occur, the devices for which may be assumed to be the licensing policy, the capital issues control, loans by official agencies, Government patronage in the shape of purchases; discriminated fiscal policy, etc. The banking sector has merely to watch that the above clearances are obtained by the borrower to qualify for a loan, and provide credit which is normally demanded for manufacture and trading purposes, as it is presumed to exist under our conditions.

Besides, I would say that deficit finance, as we understand it in the Government sector and as officially defined, is not the conventional meaning of created credit which economists accept the world over. Deficit finance in India, in so far as Government is concerned, is a parochial and a limited concept. It excludes many other elements which also should legitimately be included within the definition. For instance, only bonds held by the private individuals and institutions should be excluded from total holdings, whereas that of RBI itself and banks, Life Insurance Corporation and Unit Trust should be included. This is not done. Instead Treasury Bills outstanding and variations in Government balances are alone considered. Lest I should be misunderstood, let me state that I am not talking here of the net bank credit to the Government sector calculated by the RBI. I am referring to the deficit mentioned in the Economic Surveys. Now if actuals of created credit are to be included in this measure of deficit finance in the public sector, I am sure the proportion of deficit finance in the private and the public sectors should be entirely different.

Secondly, we have referred to the high level of taxation, direct

as well as indirect. In this connection speakers have alluded to the dilemma that if taxes are reduced, Government will be forced to reduce its expenditure which means less development outlay. To this, I would like to answer: why not look at it from another side? By reducing taxes, it is quite likely that the Government is providing incentives for the people to save more, invest more, produce more, and not to evade paying taxes. Under these circumstances, would tax revenues not probably rise if we reduce taxes? Moreover, when the case is made out for a tax-cut it does not necessarily follow, Mr Chairman, as you have pointed out, that private expenditure would also thereby go down since such an expenditure has been, by and large, financed directly or indirectly, by high Governmental expenditure. The *raison d'être* of asking for a tax-cut is to increase the savings of the community, which savings may then flow into the capital markets and thereby maintain the tempo of investment. In other words, what was taken away from one sector (the public sector) would be made available to the other sector (the private sector), so that total expenditure in the system will not necessarily fall. Obviously tax-cuts will not lead to deflation in the system.

Finally, in so far as price stability is concerned, there are various ways in which one can look at it and, as Dr Brahmanand has pointed out correctly, we are concerned with structural imbalances brought about by devaluation. My paper establishes the proposition that as things stand prices are bound to rise. Government's prime responsibility is to prevent prices from rising further rather than make them go down as Professor Lakdawala has suggested. In pleading for price stability, we have to again clarify on what we understand by it. Some may be satisfied if prices rise by 4 or 5 per cent per annum average. Others may pitch it at a lower level of 1 to 2 per cent, while individuals like late Mr Per Jacobson will not permit the slightest rise (I favour the last proposition). The last group however would not rule out sectoral movements in prices. For instance if resources are to be moved from the existing advocations to the export or import substitution industries, then prices of these industries may be permitted to increase. But should our attempts at price stability break down, then repeated devaluations as other speakers have said are likely to follow. In conclusion, I hope that this Seminar will plead with the authorities for eschewing deficit finance, re-

ducing overall burden of taxes and maintaining a stable level of prices.

SHRI R. L. N. VIJAYANAGAR

I am grateful to you for the opportunity that you have given to me to express my views on the challenge of devaluation. I am only speaking from the point of view of the textile industry and in my paper, I have set out the factors, which have contributed to the increase in our costs since devaluation and have suggested the measures to be adopted on short-term basis to maintain our exports. The suggestions that I have made should receive serious consideration if devaluation should spur our export efforts.

Now referring to the discussions which have taken place here, I feel that the present difficulties are due to the sins of the past actions of the Government. The whole trouble arose because of the so-called 'socialistic pattern of society'. If it was properly understood, things would have been different. But Government or rather the ruling political party understood by socialistic pattern, highest taxes and largest public sector and, as a result, the private sector was given a step-motherly treatment. Government did not bother to study the findings and recommendations of committees like the A. D. Shroff Committee, which were available as far back as 1954, and went on increasing the regulatory and restrictive measures. Taxes were also increased steeply and in doing so they went by the advice of Professor Kaldor, who was a dissentient member of the Royal Commission on taxation in UK. The cumulative effect of those measures is that we have been reduced to the present pitiable predicament. I agree with Dr Cooper that there should be a reversal of the tax policy. Following the policy enunciated by President Johnson two years ago, America slashed the taxes and the result was the buoyancy of the American economy. Lower taxes do not mean lesser revenue for Government. It would create buoyancy in the economy which would bring in larger revenue. We should suggest to Government that if the capital market is to be revitalized, the community's savings should be allowed to remain with the members of the community and should not be com-

pulsorily drawn into the national exchequer in the shape of annuity deposits and high taxation. As suggested by Dr Cooper, the 10 per cent surcharge on tax should be reduced, if not abolished. If this is coupled with the abolition of annuity deposit, there will be a larger flow of funds and the competition which would set in to claim these funds will channellize the flow into industries which are capable of delivering the goods. I also agree with Mr Prabhu Mehta in the analysis of the whole situation. What we should now plead with Government is that there should be an element of realism in their policy and with regard to export industries in particular, we should suggest that the whole machinery should be simplified in the matter of grant of tax credits, in the matter of making available foreign exchange for publicity abroad and for travel and other cognate matters. In this connection, I am to point out that there is a Market Development Fund. I do not know to what extent this Fund is made available to textile industry to carry out vigorous publicity in foreign markets.

Another drawback which I observe is that our Government do not take the trouble of examining what is happening in other countries. For instance, recently the German Textile Industry brought out a publication to point out that the developing countries are giving much larger protection to their textile industries than what is being done by the developed countries. Similarly, in the EEC countries, the Economic Commission has made several recommendations for revitalizing the textile industry of Europe. In our country, we find that our textile industry has become the victim of most irrational policy followed by Government. Up to 1963, the industry was not allowed to expand at all. The weaving sector was frozen. Government realized late in the day that the things were going bad. It was only at the end of 1963, they took a decision that there should be expansion of the organized cotton mill industry. Had they been careful right from the beginning and had they heeded the advice of the competent people, things would not have been what they are today. The textile policy that was followed during the Second Plan period was so bad that we had a phenomenal development of powerloom industry which was highly ill-planned lacking organizational ability. At the time when the Kanungo Committee went into an examination of the various sectors of the cotton

textile industry, namely 1953, there were about 24,000 powerlooms. In the next 10 years, we find that the number of such looms had gone up to more than 1.60 lakhs, in spite of the statutory provision to the effect that no person shall install or acquire any loom without the permission of the Government and a substantial number of such looms had been installed without permission. If there had been healthy forces of competition, only efficient powerloom units would have come into existence, but due to ill-conceived policy of the Government, the powerloom industry is thriving because of the protective wall built in by excise concessions. We have, therefore, got today 1,60,000 powerlooms which are good, bad and indifferent and it has become the responsibility of the Government to look after them. We have thus perpetuated an inefficient industry at a time when we should have highly efficient industries for export purposes. In countries like England and Europe, there has been a strong tendency towards verticalization while under our Government's policy, the textile industry is being driven to become horizontal. No mill today is interested in the weaving side since it is not profitable because of the huge excise concessions in favour of powerloom sector.

My submission is that the Government should be very realistic in approach if they want that the exports of our cotton textiles should go up. They should see that the industry's cost structure is not distorted and for that purpose I have made several suggestions from the long-term point of view. I have also suggested in my paper short-term measures to prevent our exports from falling.

SHRI G. R. PONKSHE

Thank you Mr President. I will be very brief. I will raise one or two points. One is about the interest rate—Dr Brahmanand has already spoken on that, he is not here. I suppose his point was that as long as the return on investment exceeds the interest rate, it does not matter how high the interest rate is. It is possible to agree with him there. But taking into consideration

the political situation in our country and the general prejudice against high profits, it is difficult to envisage a return higher than 10 or 12 per cent on investment, and that is why it is a low interest rate that can revive the capital market.

Another comment I wish to make on Dr Brahmanand's remarks is that I do not agree that the capital market is in the doldrums simply because the rate of savings has fallen. My submission is that savings are going into unproductive channels because high taxes and diatribes against capitalists have the effect of repelling the savers from the capital market. In support of this contention I may point out that land prices have risen ten-fold or more during the last five or six years.

There are one or two other points I would like to make. One is about excise duty. It has been said by Mr Parikh that excise duties should be reduced with a view to holding the price line. But the Government's idea in imposing excise duties is not so much as to raise resources—that is incidental—but to curtail consumption, and unless you curtail consumption, you cannot export—that is the thinking. I do not know whether any reduction in excise duty will serve that purpose.

As for lowering costs—that point was made by Mr Parikh again—I believe that there are only two ways of lowering costs. One is to increase the load of work per man and the other is to introduce automatic machines. Both are difficult propositions, the first on account of political pressure and the other is ruled out on account of paucity of foreign exchange. The only hope, however, lies in increasing the load per worker, because that is in the hands of our leaders.

If I may refer to Mr Kamalnayan Bajaj's point about Mr Krishna Menon's suggestion regarding devaluation of the dollar, Mr Bajaj has completely misuderstood Krishna Menon. Even if the dollar is devalued in the sense that Mr Krishna Menon wants it, there will be no advantage to the rupee, because after the dollar is devalued, with the present devaluation of the rupee, the dollar will still cost Rs. 7.50. Mr Menon wanted it the other way about. The only beneficiary of Mr Menon's proposal, however, will be the Soviet Union and South Africa and we will have no benefit at all. There is no reason why we should work for devaluation of the dollar.

Dr D. K. Shukla

In order to prescribe the policy measures to meet the challenge of devaluation we should be clear about the objectives to be achieved. We have primarily devalued the rupee in order to reduce the deficit in our balance of trade. Now, we find from the analysis of the impact of devaluation on our balance of payments that it is not likely to be helpful in reducing the deficit in our balance of trade, because, by and large, the elasticity of demand for our exports is not likely to be higher than unity. Hence, even when we may have to export more in terms of quantity, the nation as a whole may not be able to earn larger amount of foreign money. Therefore, naturally devaluation cannot be regarded as a praiseworthy decision taken by our Government. Anyway, the important impact of devaluation will be on our terms of trade. It will change the terms of trade adversely to our country. It is because of this adverse effect that devaluation is normally undertaken by a capitalist economy only when it is suffering from depression at home and at the same time from deficits in its balance of payments. Under such circumstances devaluation may be regarded as the appropriate remedy, for what devaluation, in fact, does is to transfer the monetary demand for goods from foreign markets to the home market. The transfer of demand towards the home market generates expansionary forces in the internal economy, and at the same time it is likely to reduce the deficits in the balance of trade. However, the expansionary effects in real terms of output and employment can materialize only in a situation of depression, when productive activity is constrained due to lack of effective demand. The expansionary effect of devaluation in an initial situation of inflationary pressures cannot yield any real benefits but can only lead to accentuation of the inflationary situation. Now we have been suffering from inflationary pressures since the beginning of the Second Five Year Plan. It is true that in certain sectors of our economy recently we had unused plant capacities. But this under-utilization of productive capacity was of a structural nature. It was not largely due to the fact that there was not enough demand for goods; but it was due to the fact that raw materials and other factor supplies were not available. Therefore, in this situation where production is restrained

by structural bottlenecks, devaluation by itself will not be helpful in increasing production; on the contrary, devaluation will certainly add to the inflationary pressures by transferring demand from outside to the internal market. Hence, the problems which arise specifically as a result of devaluation are: (*i*) how to counteract the inflationary pressures, (*ii*) how to avoid the terms of trade disadvantage, and (*iii*) how to earn a larger amount of foreign money in order to reduce our balance of trade deficits. The first thing necessary to achieve these aims is to neutralize devaluation by a specific system of subsidization of imports and by a specific system of export taxes. Now this is what we are trying to do in fact. We have decided to subsidize foodgrains. We have also tried to introduce certain export duties as well as certain export incentive schemes. These are the measures taken in the right direction, for no blanket exchange rate will prove to be beneficial to our system. As selective control of credit is recognized as the appropriate weapon of credit control in our economic situation, similarly we will have to have a selective approach, commodity-wise, in the matter of our foreign trade. In this way, by neutralizing devaluation where it is not beneficial to us and by reintroducing the system of specific controls and incentives we can meet the challenge of devaluation in the sphere of our balance of payments. However, even after these measures are taken, the general economic problems such as inflationary pressures, the stagnation of agricultural output, and the slackening of our growth rate will have to be resolved by us. Devaluation by itself is not likely to be helpful in solving these problems.

Now coming to these general problems, speakers after speakers in this Seminar have been unanimous in stating that inflation has now become a very serious problem contronting the economy. I think, Sir, we are very much right here. But the remedies suggested here so far were, really speaking, not of a genuine nature, going to the roots of the problem of inflation. For remedies suggested here were to reduce taxes, and to avoid wasteful expenditure. It may be that in certain spheres taxes are acting as disincentives, or it may be that there are some wasteful expenditures going on in the economic system. But the basic wrong which is perhaps happening and which has happened to our economy is not because of such small forces

working here and there. But our economic weaknesses, to my mind, can largely be attributed to two factors. The first of these factors is of overall importance: it is the inability of our planners to raise our internal rate of savings adequately. In the First Five-Year Plan planners had given a model of long-term growth in our economy wherein they wanted to raise the internal rate of savings by keeping the marginal rate of savings at the level of 20 per cent during the First Plan, and thereafter raising the marginal rate of savings to 50 per cent. But the marginal rate of savings has not, in fact, touched a level higher than 20 per cent till the end of Third Plan. Now the average rate of savings, therefore, has not adequately risen; and we have proceeded with development as well as defence expendiditures. This has created a big gap between our normal *ex ante* savings and our investment expenditures (including defence and other unproductive non-consumption expenditures). In fact, it is this disparity between *ex ante* savings and *ex ante* investments which lie at the root of both the inflationary pressures as well as our balance of payments disequilibrium. Now in general, in order to reduce the gap between *ex ante* investments and *ex ante* savings, we should not think of reducing our development efforts. For our Plans are not very ambitious, because if we take the growth rate or the rate of capital formation that we have achieved and compare these rates with those of the ECAFE countries and others, we find that our growth rate and the rate of capital formation are not in any case comparatively high. Also, if we take into account the rate of growth of our population of about 2.5 per cent per annum which is much higher than what the planners anticipated during the First Five-Year Plan, naturally an investment rate of 14 per cent cannot be considered high. So the basic question before us is to raise the rate of our savings by restraining consumption. Uptil now we have not properly succeeded in restraining the growth of consumption in our economy because somehow or other, the planners have allowed non-essential consumption to grow at a substantially high rate during the early stage of our planning along with the growth in essential consumption. The whole problem of inflation as well as that of the balance of payments disequilibrium has arisen because of our failure in raising our rate of savings by restraining the growth of non-essential consumption.

Now if we try to think of the second important factor responsible for our economic ills, we find that it is the relative stagnation on the agricultural front. In the matter of agricultural stagnation we have to examine how far technologically we have taken measures so that agriculture can improve. We must also examine how far land reform policies of the Government have arrested the growth of agricultural production. Not only we have suffered from agricultural stagnation and therefore, agricultural surpluses, which should provide a large part of investible surpluses, have not adequately risen in our country, but also we have failed to take proper steps to mobilize agricultural surpluses either by way of taxing agriculture or by allowing the terms of trade to go against agriculture. While the direct taxes on agriculture in the form of land revenue and agricultural income-tax increased by 137 per cent during the periods 1951-52 to 1964-65; the total tax revenue (of States in India) increased by about 247 per cent; and agricultural taxation which formed 18.5 per cent of total tax revenue of states in 1951-52, formed only 13.6 per cent of the total tax revenue in 1964-65. Thus, the relative contribution of agriculture to the total government revenues has declined during the planning period. Also, during the planning period the terms of trade between the agricultural and the non-agricultural sectors moved in favour of agricultural rather than against it. This means that we have failed on the agricultural front both in the matter of generation of agricultural surpluses as well as their mobilization. Almost all our economic ills such as inflationary pressures, balance of payments deficits, and the paucity of resources for development can be attributed to these two factors, viz., the failure to raise adequately the rate of internal savings, and the relative stagnation of the agricultural output. If this analysis is correct it means that if we really want to solve the problems facing us we should curb internal consumption of non-essential items for at least a 5-year period or a 10-year period and we must take measures to increase agricultural production, to generate agricultural surpluses and to mobilize them.

Conclusions and Recommendations

The Seminar on 'Challenge of Devaluation' has given careful consideration to the background leading to the devaluation of the rupee and its various implications affecting the future course of the economy.

2. The Seminar notes that in the context of innumerable distortions and imbalances prevalent in the economy such as stagnancy in agricultural production, persistent inflationary pressures and serious depletion of the foreign exchange resources and the rapid growth in population combined with drought conditions consecutively for two seasons, Government felt that action in terms of the devaluation of the external value of the rupee had to be taken in an effort to put the economy on a sounder footing and pave the way for its future development.

3. The Seminar has examined the possible impact of devaluation on efforts at export promotion and import substitution and has come to the view that if the opportunity provided by devaluation for restoring the health of the economy has to be fully availed of and the benefits expected to flow from the same effectively realized, early and energetic steps should be undertaken

to step up agricultural and industrial production. Such measures will have to emanate from an overall integrated approach and its efficacy should be determined in terms of the degree to which it is able to help in reducing the adverse impact of devaluation on the economy and reaping the maximum of benefits. These objectives can be achieved and the challenge of devaluation can be successfully met only if purposeful follow-up action is taken without further loss of time so that they bring about an all-round increase in production, creation of exportable surpluses, reduction in costs of production and improvement in quality, thus increasing the competitiveness of our products in the foreign markets. With this end in view, the Seminar recommends the following measures to be taken in various spheres of the economy.

4. *Agricultural Production*

Agricultural production, both of food and cash crops, continues to be unsatisfactory in spite of sizeable investments that have been made in the three Plans. In the opinion of the Seminar, this has been largely due to a lacuna in the organization and in the implementation of decisions in the agricultural field. The Seminar recommends:

(*a*) that the field organization at the villages, taluka, district, State and Central levels should be toned up;
(*b*) that agriculture should be treated as an industry and should be allowed to run on modern scientific lines, creating opportunities for it to derive economies of scale. Efforts should be directed towards agriculture to reap the full benefits of scientific management through the use of improved implements such as power tillers, tractors and consolidated holdings;
(*c*) the availability of essential inputs such as fertilizers, improved seeds, pesticides etc., should not only be liberalized, but the farmer should be educated in a judicious use of these facilities.
(*d*) in the context of shortages, several State Governments have resorted to monopoly procurement and compulsory levy of foodgrains. These steps appear to encourage a diversion to other lines of production. This has impeded

increased production of food grains. There should, therefore, be a review of these policies in the context of the overall urgency of increased food production.

5. *Industrial Production*

Increase in industrial production can be achieved (a) by fuller utilization of existing industrial capacity, and (b) by setting up of new industries. The most important factor impeding the full utilization of capacity of the existing industries is the paucity of raw materials, components and spare parts. To the extent that these are not available from indigenous sources, they have unavoidably to be imported from abroad. Government have taken steps in that direction. The Seminar recommends:

(*a*) that the process of issuing import licences and securing imports under the revised policy should be speeded up and industries enabled to plan ahead their programmes of production with a reasonable assurance that they could be adhered to without interruption through a continuous supply of the required raw materials to be imported from abroad;

(*b*) that in the process it must be seen that imports so effected do not in any manner adversely affect the working of ancillary industries, particularly in the small-scale sector which have been developed at considerable cost and effort;

(*c*) that while Government should facilitate imports of essential items of raw materials and components at comparatively lesser rate of duty, it should progressively discourage the imports of materials which could be had from indigenous sources either to a full or to a very large extent by subjecting such imports to a high rate of duty; where components are being indigenously manufactured Government should exercise the greatest amount of discretion in allowing imports of the same; and

(*d*) that large industries should make special efforts to obtain their requirements from ancillary industries in the country.

6. *Controls*

A factor which has seriously come in the way of effective func-

tioning of industries is the prevalence of a number of controls at various stages of production and distribution. These controls, whatever their motivations, have only resulted in imparting rigidities in the working of industries and impeding production. The Seminar notes with satisfaction the increasing awareness being shown by Government of the frustrating effect of controls on production and the action taken in the direction of removing as many of them as possible. The Seminar stresses:

(*a*) the importance and urgency of continuing the process of weeding out avoidable controls, regulations and procedural formalities;
(*b*) the need for reviewing the licensing provisions for new industries, especially those which are export-oriented or which are likely to assist agricultural development or based solely or largely on indigenous supplies; and
(*c*) that once a decision in regard to any relaxation or removal of control is taken, every effort should be made to implement the same expeditiously.

7. *Finance*

The sucessful working of industries depends upon the availability of finance at reasonable cost. The requirements of industries for working finance, consequent on devaluation, have measurably increased. Additional finance and credit facilities will be necessary for financing the liberalized imports due to higher cost of devaluation, for fuller utilization of domestic resources and for increased exports. The existing credit policy has acted, in the past, as a severe handicap. In the alerted context, the difficulties on this score are all the more emphasised. The Seminar, therefore, recommends that early opportunity should be taken to review the credit policy with a view to ensuring that adequate additional finance at a reasonable cost is made available for productive purposes.

If industries find it difficult to secure adequate working finance, the position in regard to availability of capital finance is more unsatisfactory. Under the high level of direct taxation, both personal and corporate, the sources of private savings are increasingly diverted. Industries have restricted opportunities for ploughing back their profits. The scope for raising rupee

finance by selling equities in the capital market is almost non-existing in the context of continued sluggishness in the capital market. Financial Institutions, specially set-up for this purpose do not have sufficient resources with which to meet the capital requirements of industries.

The Seminar, therefore, urges.

(*a*) that the 10 per cent surcharge on personal and corporate taxes levied under the Finance Act, 1966, should be removed with the condition that a separate reserve on the lines of the Development Rebate Reserve would be created by the person or the company out of the amount so saved and the funds of this reserve would be solely deployed in meeting the needs of expansion;

(*b*) that development rabate and depreciation should be allowed on the enhanced rupee cost of a project resulting from devaluation;

(*c*) that the whole position be reviewed with a view to ensuring that the capital market functions effectively and with vigour;

(*d*) that the financial institutions are assured of adequate resources to meet the medium and long-term requirements of industries; and

(*e*) that the need for term-finance being made available to industries on comparatively easier terms is examined and in that context, the feasibility of creating conditions conducive to encouraging a trend of lower dividend expectancy on capital is considered.

8. *Cost of Production*

The immediate concern all-round should be to bring a lowering of the cost of production or in any case to prevent it from increasing through simultaneous action designed to contain the pressures impinging on costs. Towards this end, a purposive effort at increasing productivity has to be made which alone, in the long run, can help reduce the cost of production. With this end in view, the Seminar recommends:

(*a*) that the industry should concentrate on more efficient

employment of its scarce resources and more rational and scientific management of its affairs;

(*b*) that the labour should not only restrain its demands for increased pay-load but, on the other hand, make a sustained effort at increased production through application and hard work.

9. *Exports*

In the field of exports, the twin objectives to be attained are (i) the availability of adequate supplies for export purposes both of agricultural and industrial products and (ii) to see that these products are sold in the foreign markets at competitive prices. At the same time, additional exports will have to be effected to augment the foreign exchange resources. The basic remedy is, therefore, to increase production to the maximum extent possible and to endeavour to create an increasing demand therefore in the foreign markets. So far we have sought to increase the competitive capacity of our exportable products through the grant of various incentives.

All these incentives have been withdrawn at the time of effecting devaluation. Devaluation, no doubt, has given a price-edge to some of the commodities which are exported. The advantage resulting from devaluation is, however, found in many cases not adequate to off-set the benefits of incentives which were previously in force. The case of some of the products of engineering industry and chemical industry is an instance in point which emphasises the need for additional assistance for not only sustaining the present level of exports, but for giving a further push to these exports. While withdrawing the schemes of incentives, Government announced that they were considering alternative measures of support to export. These measures have not been announced and in their absence a situation of uncertainty has developed leading almost to a standstill in export activity. The Seminar, therefore, recommends that:

(*a*) industries should, on a voluntary basis, consider the feasibility of formulating a scheme of exports on a certain percentage basis;

(*b*) Government should take an early opportunity to an-

nounce their decision on the question of measures of support to facilitate exports;

(*c*) Government should make arrangements for the day-to-day study of the effect of the export duty on the particular commodity affected, so that timely corrective action could be taken as soon as there is the slightest indication that such a duty is having an adverse effect on the volume of export of that commodity. A quick and flexible policy of adjusting export duties should be evolved so as to ensure a smooth maximum flow of exports.

(*d*) There are industries, such as Engineering, Cotton textiles, Basic Chemicals, Pharmaceuticals & Soap, Woollen etc., which are handicapped and would not be able to play their proper role in fulfilling their export targets without being assured of some imports. It is necessary that a practical across-the-table examiation is made of the problems of these industries and others. Government should, therefore, call meetings of leading all-India industrial organizations and respective Export Promotion Councils, find out the position in regard to its export capacity, study the problems in the way of facilitating exports and then decide as to whether any measure of support is necessary to secure increased production and export;

(*e*) the possibility of intensively cultivating the markets in the neighbouring countries should be explored. The feasibility of export of capital goods and technical know-how to the neighbouring countries should be actively considered; and

(*f*) give necessary facilities to exporters to enable them to pursue dynamic salesmanship in foreign markets.

10. *Prices*

The increase in production, augmentation of exports and saving of foreign exchange through import substitution are all desirable objectives. But their importance and utility will have to be judged in their ablity to tackle the main issue confronting the economy, viz. the prevailing inflationary pressures. Inflationary pressures have, no doubt, to be reduced, but the immediate problem is that of containing them. Some improvement

in this regard, can be expected by fuller utilization of the existing capacities and thereby ensuring better distribution of the overhead costs. The factor, however, which significantly effects the ultimate price of the products is the levy of a number of indirect taxes. It has been estimated that the element of tax component in the price of various commodities works about 30 to 40 per cent of the ex-factory price. It is being increasingly realized that indirect levies, instead of being anti-inflationary in their impact, have resulted in high prices. The Seminar, therefore, recommends:

(*a*) a review of the excise levies with a view to giving relief to the extent possible in the high prices of goods and materials particularly of an essential character by reducing such duties. The action in this direction should be facilitated by the decision of the Government to effect economies in its revenue expenditure to the extent of 3 per cent which indeed is very inadequate;

(*b*) the zonal system of distribution of foodgrains should be abolished with a view to obviating the persistence of disparities of supplies and prices in different parts of the country which has helped create artificial shortages and emphasized the distortions in prices.

(*c*) that Government, business community and the citizen should each practice austerity wherever possible and co-operate in seeing that no justifiable price rise takes place affecting the cost of living of the common man.

11. *Fiscal Policy*

The Seminar re-emphasises the point that while the rates of direct taxation are at prohibitively high levels, indirect levies such as excise duties have only brought about an increase in prices and not a reduction in the consumption demand as envisaged. It is necesary to realise that 'public expenditure does not become productive merely by being described as investment. It can be misdirected and wasted.' A substantial part of the resources ostensibly raised for developmental purposes have been diverted for non-plan non-development expenditure, a

good part of it being of a demonstrative nature. In this context, the Seminar feels:

that it would be appropriate to bring a reorientation of the tax structure in the context of the imperative need to rehabilitate the economy.

12. *A Basic Re-Thinking on Economic Issues*

The Seminar is of the considered view that all the objectives of increased production can only be realized by positive encouragement to initiative and effort. This is possible to ensure, in an environment of fresh thinking on economic issues in terms of a pragmatic and realistic approach free from any ideological pre-dilection or prejudices. The Seminar notes that a certain measure of pragmatism appears to be brought to bear on decisions for permitting industries to be established in one sector or the other and recommends:

that the process should be further encouraged.

The economic malaise which has forced, as it were, devaluation of the currency is, in the view of the Seminar, the cumulative result of continuous living beyond our resources. The Seminar, therefore, feels:

(*a*) that the Plan should be realistic, based on real resources that are in sight and which can be raised in the near future without entailing a crushing burden on the common man and hurting the productive apparatus;
(*b*) that deficit financing should be completely eschewed. The Seminar regrets to find that even in the present context there is no adequate or effective realization of the need for practising the necessary degree of discipline in fiscal matters and that deficit financing still continues to be resorted to;
(*c*) that all wasteful expenditure is avoided and non-plan non-development expenditure is drastically curtailed;
(*d*) that the budgets, both at the Centre and in the States, should be balanced on the basis of economies in expen-

diture rather than on augmentation of revenues to meet ever-increasing expenditure;

(*e*) that the scheme of development should first concentrate on:

(*i*) industries which are likely to assist agriculture and exports;

(*ii*) speedy completion of the projects already under construction;

(*iii*) projects which have a short gestation period and an assurance of adequate return on capital employed, within a reasonably short period;

(*iv*) maintaining a balance between the rate of growth of capital goods and consumer goods industries. The above should constitute the basic core of the Plan which should be implemented without any delay. The rest of the Plan should be undertaken subject to other conditions such as the availability of resources, both internal and external.

(*f*) that the scheme of development should be "Swadeshi-oriented" in the sense that it should comprise of more and more indigenous content thus lessening the dependence on foreign assistance and hastening the process of self-reliance. In the private sector, the effort should be directed towards securing all the wherewithals of setting up of new industries from collaboration should be made only in exceptional and unavoidable cases.

13. *Consultation Between Government And Business Community.*

The Seminar is of the view that in the present context there is imperative need for an all-round effort from all sections of the community to tackle the basic issues confronting the economy particularly in the context of the conditions created by devaluation of the rupee. It, therefore, recommends:

(*a*) that the business community should be taken into confidence and that to begin with the Prime Minister should convene a meeting of heads of Industrial and Manufac-

turing Organizations and principal Chambers of Commerce in the country to discuss the problems consequent on devaluation; and

(*b*) that an *ad hoc* Committee consisting of a few representatives of Government and the business community should be set up to examine on a continuous basis the day-to-day problems consequent on devaluation and to suggest ways and means of solving the same without any loss of time.